BOSTON UNIVERSITY

College of Business Administration

THESIS

Investment Status of Investment Company Shares

by

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(B. S. in B A Boston University, 1948)

Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

TABLE OF CONTENTS

Page

TABLE OF CONTENTS OF TABLES

TABLE OF CHARTS

CHAPTER I
INTRODUCTION TO THE PROBLEM

Introduction

The purpose of this report is to determine the investment status of investment trust stock. During the decades of the twenties the stock was widely invested in by rich and poor alike. Unfortunately like all young industries in the early stages of growth it was the prey of unscrupulous promoters. Large investment banking houses established affiliated investment trusts for the purpose of getting rid of issues that the bankers failed to sell. The crash of 1929 shook the industry very heavily and over 56 percent of the investment companies failed from the period 1929 to 1935.

Significance Today

Today we find the existing investment companies following a wise, more conservative policy compared to the mad speculative days of the twenties. Today a new problem has arisen, the capitalistic system is in dire need for investment capital from the American public. The public has not forgotten their experience with the stock market and distrust it very much. However, the investment trust has a definite place in the financial world, having over 125 active companies with an estimated 1,000,000 stockholders and assets totaling over 2.2 billion dollars. The answer to the financing of new capital for expansion programs or the replacement of obsolete equipment is in the small investors. In order to reach them, financiers must convince

them they will get protection in their investment and what greater provision for protection can be found except in the investment trusts.

Investment companies, because of their wide divirsification of shares in which their funds are invested in, guarantee investment company shareholders the safety of divirsification that the small investor could not practice.

Thus today with the finance field stressing salesmanship to the small investor, the problem of determining the investment status of investment company stock is important, as the industry through its safety in divirsification and skilled management maybe the answer to save the capitalistic system.

Therefore, if the investment status of investment company stock is well assured, this may be the means of attracting the investment capital needed by private industry from the small investors. However, the public must be educated and convinced that the manager's have learned their lesson taught to them in 1929-1934. Of course many of the investment trusts have an excellent record of safety and conservativeness, yet the public, meaning the investor of small means, must be educated and convinced that the investment trust is the answer to his investment, in that it provides expert management of the fund and portfolio and gives safety through wide divirsification of the securities held by the investment company.

Other Reports of Investment Company Securities

Unfortunately many of the reports on investment companies were written in the period of the twenties, when the investment companies were considered financial fads, in which everyone investing would become fabulously rich. Thus many of the books and articles printed gave wide and extravagant claims as to the future of investment companies.

After the depression of 1929 and the very depths of it in 1932 many articles written on investment trusts were about the evils of investment trust, such as the article by Flynn, "Investment Trust Gone Wrong," printed by New Republic Magazine. However, there were many valuable articles that honestly and impartially criticized the investment trust among them are: "Investment Trust and Funds" by E. C. Harwood and Robert L. Blair, published by the American Institute for Economic Research and "Shares in Mutual Investment Funds" by Alec Brock Stevenson, published by the Vanderbilt Press.

Unfortunately there are few articles that have been published on investment trust securities as an investment. They have either covered the history, development, or economic function of the trusts.

I believe that a study of this problem involves a study of the origin and the past history of investment trusts in America; the evaluation of the investment trusts according to earnings; a study of the competence and experience of

management in regards to the fund; the investment policies and objectives followed and the trends of business activity and its effect on investment trusts.

CHAPTER II
HISTORY OF THE INVESTMENT TRUST COMPANIES

The first investment trust company was organized by King William of the Netherlands in August 1822. The investment trust company was known as the Allgerment Nederlandesne Maatshappy which later was changed to the Societe Generale de Belgique. The original purpose of the company was to provide the means for individuals to invest in foreign government loans which at the time offered the greatest security and tempting returns. Yet while the investment trust company idea had its birth in Belgium it did not catch hold until the middle of the 19th century, some forty years later.

The British were the ones to seize upon the investment trust company as a means of investing accumulated savings of wealth which had been derived from the Industrial Revolution that had swept England during the latter part of the 18th century.

It has been said by Arthur Grayson, who wrote "Investment Trust" in 1929, that the use of the investment trust company came about because many people who lacked the knowledge and skill to wisely invest their savings sought out the investment trust company as a means for their investing. The companies could through skilled management, and diversification of investments protect the individual investor's funds much more than the individual himself.

The conditions which caused the investment trusts in England to flourish were:

1. Lack of investment opportunities in England forced

the investors to look to the investment trusts to wisely invest their funds.

2. The attractive investments were in foreign government bonds and other securities which required a selective skill that only investment trusts could handle.
3. The public clamoured for the chance to invest their savings in investment trust companies without any solicitation on the part of the investment trust company.
4. The investment policy of the investment companies of buying diversified number of securities on the basis of income and not on appreciation in principal.
5. The profits gained from the sale of securities were set up in reserve accounts rather than distributed as earnings. This conservative method helped stabilize earnings very much.

The investment trusts from the period of 1860-1890 flourished rapidly and unsound financial practices went hand in hand. However, in 1890 the great Baring Panic and the revolutions in South America caused many investment trust companies to be found with unmarketable securities at riduculously high prices.

After learning their lessons the relative successes of the Scottish investment trust companies tended to encourage

the establishment of many investment trusts in Europe.

The period 1900-1914 saw the English investment trusts lose their investments in some European countries which were largely offset by the appreciation of American securities held in the portfolio of the English investment trust.

It was the success of the British and Scottish investment trusts that encouraged the American investment companies to be organized.

American Investment Trust Development

After the Armistice of 1918 there was a period of great tension as many of the European powers struggled to adjust their economy from a government geared inflexible giant back to a free competitive economy. Thus many countries found themselves looking for capital to finance the transition from war to peace.

America emerging from the war as a financially rich creditor nation was the one nation that Europe looked to, for venture capital, to finance its reconstruction. It was said that many nations could not sell their securities directly to the American public and because of this the Edge Act an amendment to the Federal Reserve Act was passed on December 24, 1919.(1) It provided for the establishment of a corporation whose securities could be sold to the American public with secured collateral in the form of corporation. Thus the theory of investment trust was developed and introduced in the United States. However, the act failed to produce the

(1) Arthur Grayson "Investment Trusts" John Wiley & Sons 1928 page 136

anticipated results. A few trusts have been organized under its provision but none of them were successful. Grayson claimed that the failure of the Edge Act was caused by the following conditions: (1)

1. Because of the 1920 depression which tended to discourage the investment of capital abroad.
2. The question of German reparations which at that time remained unanswered
3. The fear that many European companies despite their honest intentions may be forced to default on their bonds.

The period of intensive development of the American investment trust came about in 1921, when the International Securities Trust of America was organized. This Massachusetts trust for many years was one of the largest investment trusts in the United States. In this period of inflationary times there came the development of many types of investment trust companies. Among them were:

1. Contractual Type-This type came into existence as a result of a contract or legal agreement whereby all parties were participants such as the Massachusetts Investment Trust.
2. Statuatory Type-This type came into existence as a result of a legislative act or by virtue of the granting of a charter by some legislative body empowered to do so.

(1) Arthur Grayson "Investment Trusts" John Wiley & Sons 1928 page 136

According to the Type of Management

1. The pure management Type-Management has full power to change the portfolio as it sees fit in order to adjust itself according to business conditions.
2. The fixed type-This type has a fixed portfolio which could not be changed except upon an event decided upon in advance and set forth at the time of the establishment of the portfolio.

According to the Nature of the Portfolio

1. The Common Stock Type-This type invests its entire portfolio in common stock.
2. The Bond Type-This invests its entire portfolio in bonds.
3. The Balanced Type mixing bonds and stocks in the portfolio.

According to Type of Industry

1. General-No restriction on what percentage of the portfolio be invested in certain industries.
2. Specialized-The entire portfolio is invested in one or two industries such as an investment trust specializing in the aviation industry.

According to the Classes of Securities Issued by the Trusts

1. Open end trust-type that has no restrictions as to the amount of securities issued by the investment company.

2. Closed-end trust-This type has a definite capitalization figure and can not issue any securities beyond that capitalization figure.

Beginning in 1924 the investment trust movement rapidly gained in momentum. By 1925 there were twenty five investment trusts with assets totaling nearly $150,000,000. an in November of 1927 there existed one hundred trusts having estimated resources somewhere between $300,000,000. and $500,000,000.

There were several investigations conducted by many states with the object of revealing to the public such pertinent information as to provisions of the trust agreement, portfolio, balance sheet, income, auditing practices and responsible management officials connections with selling agencies, compensation of officers and trustees, differential between cost of holdings and the selling prices of investment companies' securities. Thus for as much as a year ahead of the 1929 debacle the investment public was warned by various state commissions and financial men that the investment trusts were expanding too fast and not heeding the past experience of the British investment trust.

Despite the warnings given in 1928 there existed 150 investment trusts with a total capital of $600,000,000. In December the total grew to include 225 investment trusts with a total capital of $1,250,000,000. Finally in 1929 the total number of companies stood at 600, with resources totaling more

than $4,000,000,000. The idea had grown to such a gigantic movement that people were encouraged to put their savings into investment trusts and watch their investment grow to staggering princely sums.

Naturally with such wild ideas of gaining easy profits the managers of the investment trusts were speculating with their portfolio rather than purchasing securities with prime regards for safety of principal first and small income last.

The Debacle of 1929

When the crash finally came to America's greatest inflationary period, many investment companies purchased securities with all the available cash in the belief that they were getting common stock at low prices. Unfortunately for many of the investment companies, their portfolio's shrank in value to unbelievable figures. Many investment trusts stockholders sold their shares at prices far below the liquidating value. The Atlas Corporation, an investment, expanded greatly during the depression by purchasing many investment trust companies for less than their liquidating value and by liquidating the investment trusts pocketed the difference for a sizeable profit.

Finally in 1935 in a rider attached to the Public Utility Act[1] passed by Congress, a committee was set up to investigate the cause and reasons for the failure of the

(1) Alec Brock Stevenson "Investment Company Shares, Their Place in Investments" Trust and Estates May 1947

investment trust companies. This investigation ultimately resulted in the Investment Company Act of 1940. In Chapter VII later in this report there is a detached study of the investment trust act, but suffice it to be said here that the act resulted in more conservative management and cautious program of investments for the investment industry from 1940 to the present day.

As a result of the Investment Company Act of 1940 the investment trust companies were classified in the following classes:

1. Fixed investment trusts
2. Management investment trusts.

The Fixed Investment Trusts

The fixed investment trusts are companies organized either by a charter granted from a state legislature of by a contractual trust agreement. These companies are restricted by their charter or trust agreement in what securities their portfolio may consist of and must be held permently, unless, some predetermined event stated in the charter or trust agreement instructs the managers otherwise.

This type of trust company suffered heavily during the depression years of 1930-1935. It was found by the New York Stock Exchange that the causes of the failure of fixed investment trusts were: (1)

1. Too much faith in the value of the portfolio not depreciating in value by the stockholders.
2. Excessive commissions to the organizers of the

(1) Speech by Mr. Richard Whitney "The Exchange" May 1933

trust company

3. Payment of dividends to the trust stockholders when it was not justified which resulted in the depletion of the working capital of the trusts.

Management Investment Trust Companies are defined by the Securities Exchange Commission as companies "whose funds are primarily invested in a number of blocks of diversified securities of such small sizes as to be of negligible significance with respect to control or influence."

The other classification included by the Securities Exchange Commission was the management investment holding companies in which the control or influence is said to be greater in blocks of stock or corporations by 10 to 15 percent of the total outstanding shares. All investment companies according to the S. E. C. are management companies provided they meet the requirements and are not investment banking companies. Figures taken from a S. E. C. Report dated 1938 show that of 558 investment companies 152 with total assets of $1,767,000,000. of a total $4,500,000 were management companies.

The management investment companies whose control of the portfolio is entirely vested in the hands of investment executives are split into two groups:

a. The open end Company

b. The closed end company

The Open End Company

(1) By its declaration of trust, charter or by-laws obligates itself to redeem or repurchase shares when offered by the shareholder. The price at the time of redemption shall be the current liquidating or book value of the company as of the redemption date.

(2) It daily issues new shares of stock to purchasers and has no restriction as to capitalization.

The Closed End Company

Is one which has no provision for the day to day issuance or day to day redemption of its shares of stock. Its capitalization is fixed for a period of years and usually may be bought on the over the counter market. Thus the closed end companies with capital permanently raised have a freer hand in their investment policy than the open end companies.

The open end company that is obligated to redeem shares on demand would be expected to weight their portfolios more or less with readily marketable securities of well known high quality corporations and be conscious of the necessity of maintaining a constant flow of new subscriptions for their own shares.

Thus as the capital structure of the closed end company is fixed and permanent, a larger percentage of the portfolio may be invested in the less known corporations which have a promising future because of some special situation. However, this situation may be said to only exist in general

as frequently one finds large open end companies investing in unknown and special situation securities while some closed end company is only investing in bonds, preferred stock and common stock of large well known corporation.

A later chapter will discuss in more detail the characteristics and performances of the closed and open end companies.

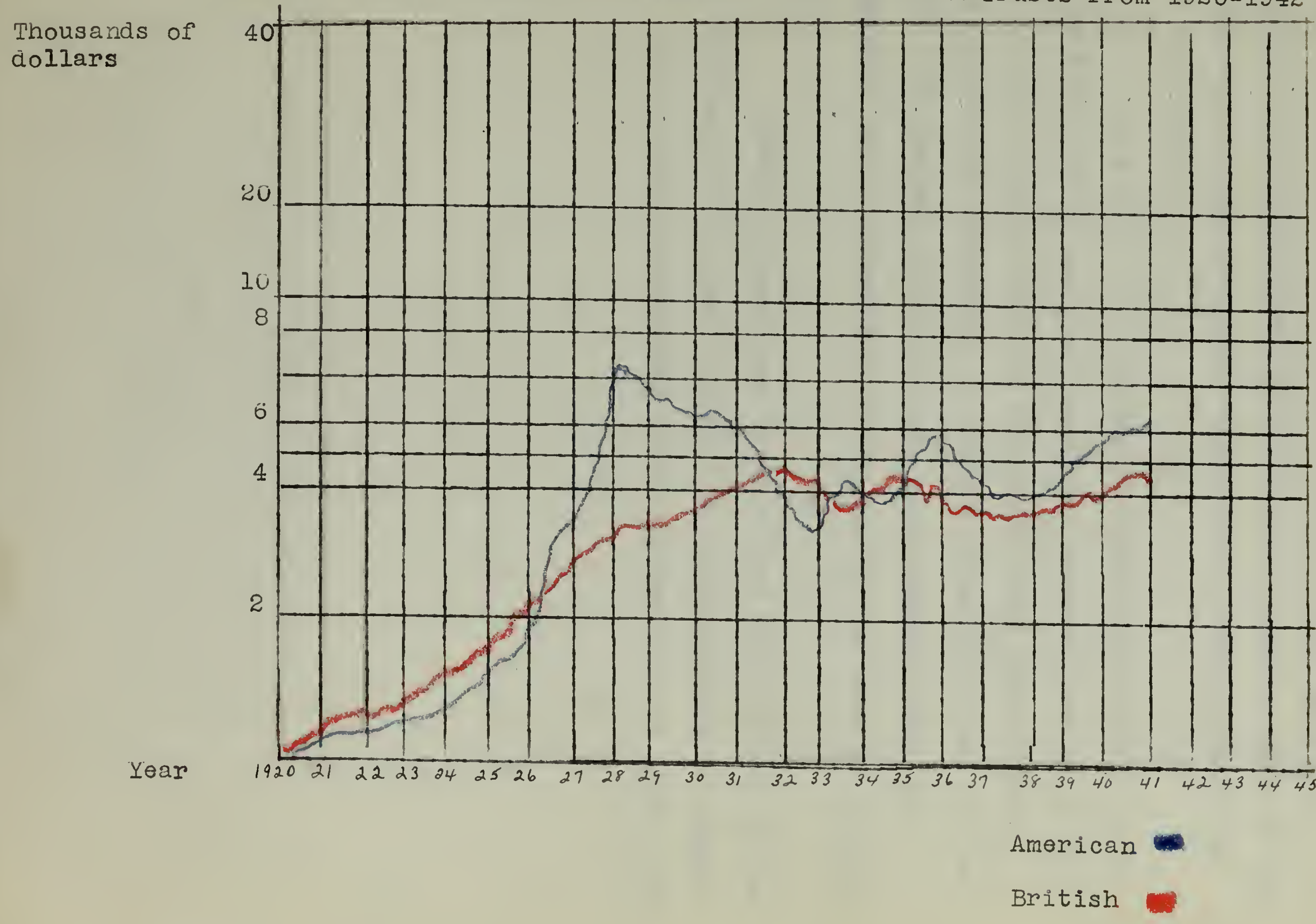
Comparison of British and American Investment Trusts

In concluding this chapter a simple comparison of American and British investment trusts finds that the British relied more on diversification and patience than the American investment companies. The British believe in the policy of charging all profits made through the sale of securities to a surplus reserve account in order to provide for any unexpected losses in the portfolio. On the other side, the Americans believed in charging profits made on the sale of securities to income for the year and distributed it as dividend and the heavier turnover of the portfolio.

A chart taken from Harwood and Blair's "Investment Trust and Investment Funds" shows a comparison of the portfolio records of both countries revealing that the British had a much more stabilized record than the American investment companies.

This situation today is still generally true because of tax provision, Supplement Q which provides that any bonafide investment trust that submits to public regulation and performs

Chart 1 The Performance of American and British Trusts from 1920-1942



Source: Investment Trust and Investment Funds" E. Harwood & Blain, Page 81

the function of permitting small investors to obtain the benefit of diversification of risk, may well be exempt from tax. In order to qualify under this rule an investment company must distribute its entire net income or else be subject to a tax for the undistributed net income, regardless of its source.

A study of 92 investment companies composed of 40 closed end and 52 open end companies reveals that 28 of the 92 or 30.4 percent were non regulated while 59.6 percent were regulated companies. A further breakdown revealed that only 1.98 percent of the 52 open end companies were non regulated while 65 percent of the closed end were no regulated.

These figures tend to show that the American policy of charging profits made on the sale of securities to income for the year and distributed it as dividends to be still true.

CHAPTER III
MANAGEMENT

The fundamental reason for the existence of investment companies is that there is no such thing as security in finance. Because of this problem investment trusts, through the guidance of skilled management and the use of divirsification, attempt to overcome and remove this insecurity.

In the article "Blue Chips Unless Recounted Often Tend to Turn Pink" (1) the author stated that at the end of 1919, of a group of sixteen stocks having an uninterrupted dividends record up to 36 years the following information was noted:

1. The value of the sixteen investments as of ohe 1929 date had dropped from 1.6 percent to 8.9 percent of the original investment or
2. The total average drop of the sixteen investment stocks was 25 percent
3. The uninterrupted dividend record received at the end of 1919 averaged about 15 years.

This article and countless other articles and statements made by experts in the finance field tries to emphasize that intelligent supervision and constant reappraisal of investments is necessary if one is to avoid a loss in his investments.

Method of Measuring Management Performance

Wise investors realize that the requisites of sound management are: The protection of debentures and preferred

(1) New York Saturday Evening Post July 26, 1930

not only from an asset but also from an income standpoint; the maintenance of portion of the fund in cash at all times, and the use of bank loans be restricted to small amounts and for a short period of time, a constant attempt to anticipate any unfavorable economic and financial developments and provide for the continual increase in reserves and earned surplus. The measurement of the performance of management varies according to the type of trust. (1)

Open end companies, for example, compute the overall management results by comparing net assets on a per share basis In computing the net asset change, all dividends per share paid out during the year are added to the total per share asset value at the end of the year, the sume of these two is divided by the per share asset value at the beginning of the year. The resulting figure shows the performance relative of the company of the year period, anything over 100 percent is said to be a gain, anything under 100 percent is a loss.

For example take the State Street Corporation's performance in 1947.

Asset value 12/31/46	$44.49
Plus Dividends	8.00
Total Adjusted Assets 12/31/46	52.49
Asset value 12/31/45	53.90

Formula	Actual Figure	Performance Relative
$\frac{\text{1946 Adjusted Asset}}{\text{1945 Asset Value}}$	$\frac{\$52.49}{\$53.90}$ =	97%

(1) Arthur Wiesenberger "Investment Companies 1948" Page 58

Results: Performance Loss 3%

In dealing with closed end companies where leverage may exist in the form of debentures or bank loans, the fluctuations per share in asset value are influenced more by the amount of leverage than by the skill of management. Because of this, the method of measuring performance is determined by comparing the change in total net assets from one period to another. Under this method the total net assets of the closing period are added to all dividends and interest paid out during the period The sum of these figures id divided by the total net asset figure as of the beginning of the period. The resulting answer is the performance relative of leverage companies.

An example of computing the results of a leverage company is the Carrier's General performance in 1946

Net assets 12/31/46	$ 8,266,722
Plus: ½ cost of 2,000 shares of common repurchased	7,180
Dividends Paid in 1946	365,445
Interest on Bonds in 1946	100,979
Total Adjusted Assets 12/31/46	$ 8,740,326
Net Assets 12/31/45	8,729,043
Less: ½ cost of 2,000 shares of common repurchased	7,180
Total Adjusted Assets 12/31/45	$ 8,721,863

Calculation

Formula	Actual Figures	Performance Relative
$\frac{\text{1946 Adjusted Assets}}{\text{1945 Adjusted Assets}}$	$\frac{\$8,740,326}{\$8,721,863}$ =	100.2%

Results Performance: Gain 0.2%

Comparison of Investment Trust Performance

There is no actual general market average that can serve as an accurate yard stick year in and year out. For practical use the performance is compared with the market averages of the Dow Jones Composite average or the Standard and Poor's 90 stock index. The latter has proven to be a better and more comprehensive yardstick of the general market's action.

The Securities and Exchange Commission recommended the comparison of investment trust performances with the index of general market action because it believed that the comparison eliminated the function and cost of management and thereby made possible the evaluation of management's contribution.(1)

The method of computing the 90 stock index is exactely the same as the one used for investment companies. However, there are some differences in the comparison of the two indices. Standard and Poor's index, for example, has an advantage over the investment companies index because it represents a fully invested position while investment companies averaged 10 percent in cash and government bonds during recent years. In comparing the performance of investment companies with the general market index care must be taken to allow for the same price level to exist for the first and last year. Otherwise if the performances is compared in a one direction market, such as a bull market the more conservative type

(1)Barrons - February 13, 1948 Page 21

investment company would appear in a poor position compared to a speculative type of investment company.

The record of 51 investment companies performances over an eleven year period has been an average increase in asset value of 59 percent while the Standard & Poor's index has been 55 percent. (1) An analysis of the period 1936-1947 shows that in 8 out of the 11 years the investment companies average was better than that of the Standard and Poor's while in the other 3 years the situation was the opposite.

Table 1 gives a summary of the management results of 41 closed end companies and open end companies both for individual years and for combined periods. Yet despite the high increase for the companies from 1937-1947 one must take into account the inflation that has appeared since 1937. Many investment companies after 1938 began investing against inflation by buying what they called "Inflation Hedging Securities." Securities such as oil stock, defaulted railroad bonds, mining and chemical stocks and armanent stocks were the cause for the large increase in the net asset value of the investment companies. However, the comparison of the results of investment companies with the Standard and Poor's index gives a reasonable evaluation of the management of investment trusts.

HUMAN FACTORS OF MANAGEMENT

There are thos factors of management that are called the intangibles because they are not easily measurable.

(1) Arthur Wiesenberger. "Investment Companies," Page 63

Table 1

A Summary of Management Results
Percentage of Average Change

Year	Closed End Companies Leverage	Closed End Companies Non Leverage	Opened Funds	Combined Companies	Standard Poor's 90 Stocks
1937	-36	- 31	- 34	- 34	-35
1938	+21	+16	+ 22	+ 21	+31
1939	-2	0	-3	-2	-2
1940	-9	-7	-8	-8	-10
1941	-7	-4	-8	-7	-12
1942	+15	+11	+ 14	+ 14	+20
1943	+37	+30	+29	+ 32	+ 25
1944	+22	+19	+22	+ 25	+19
1945	+38	+39	+35	+36	+35
1946	-1	-1	-6	-4	-8
1947	-1	-1	-1	-1	+ 6

Combined Period Results

Period	Leverage	Non Leverage	Opened Funds	Combined Companies	Standard Poor's 90 Stocks
1937-1947	+ 64	+ 68	+ 54	+ 59	+ 55
1938-1947	+157	+143	+132	+142	+138
1939-1947	+107	+109	+ 88	+ 97	+ 82
1940-1947	+116	+108	+ 95	+103	+86
1941-1947	+139	+124	+110	+120	+107
1942-1947	+162	+133	+128	+139	+135
1943-1947	+120	+109	+ 99	+108	+ 96
1944-1947	+ 64	+ 61	+54	+ 58	+ 57
1945-1947	+40	+ 36	+27	+ 32	+32
1946-1947	-2	-3	-6	-4	-2
Eleven Year Period 1937-1947	+64	+68	+54	+59	+55

The number of companies used

Leverage Closed End	1937 (18)	1938-1947 (19)
Non Leveraged Closed End		1937-1947 (6)
Open End	1937 (27), 1938 (30), 1939 (32), 1940 (33), 1941-1947 (36)	

Source: Arthur Weisenberger "Investment Companies 1948" Page 65

They include the identity of management, the personal affiliation of management officers with other companies such as investment banking houses, or as for example the Atlas Corporation which controls several companies of the various different industries; the skill and experience of management and the record of current management heads during the last depression. Some of these may be analyzed through the use of such barometers as earning records and increase in net assets over the period. Yet despite the application of statistical analyses mentioned above there remains the uncertain and usually unpredictable factors of human namagement that we must always consider.

Management according to Barron (1) is the single commodity that an investment company can sell and it must be adequately judged in all respects both on it past investment experience and as to management's human factors.

(1) Barron February 13, 194 Page 72

CHAPTER IV
MANAGEMENT METHODS OF OPERATION

Because of the nature of the industry, investment company management must have some method or technique to follow in which they can regularly supervise their portfolio and keep the losses to a minimun. We know that they do this by:

1. Diversification of investment
2. Careful research and analysis of all stocks at all times
3. The skilled experience of excellent management
4. The dollar averaging
5. The investment formula method.

This chapter will discuss the methods listed in 4 and 5, that management uses to cut their losses to a minimum.

Dollar Averaging Method

The dollar averaging method is the purchasing of given stock in equal dollar amount by regular installments which are predetermined by the investor or investment company. By investing an equal amount of money on the same security whether in high periods of prosperity or in low periods of depression, the investor will average out by paying less per share for the securities rather than try to wait for the trough of depression and invest all his money then.

An example below illustrates the dollar averaging method. Supposing an investor purchases $5,000. worth of stock each year and he does so over a period of 3 years and the table below shows how he spent his $5,000. each year.

Price per Share	No. Shares Purchased	Total Shares Held	Per Share Ave. Price all Purch.	Per Share Ave. Cost
$25.	200.	200	$ 25.	$ 25.
$20.	250.	450	22.50	22.22
$10.	500.	950	18.33	11.57

Thus we find that if the investor used the dollar average method his cost of the 3 year period would be 11.57 for his $15,000. investment. (15,000. ÷ 950 shares). This average cost per share will always be less than the average price per share. Over a long run period the investor who uses this plan will benefit by it, of course, ther are those who like to predict when the market is at its lowest point and them make the so called "killing" by investing the entire amount at the lowest point. Unfortunately, very few investors have such clairvoyance in determining the right time to purchase. The investor who follows the dollar averaging-method will not make the large profit the shrewd speculator may make, but the investor is sure of averaging out much better over the period of years if he follows this practice.

However, the use of the dollar averaging method presupposes that the investment securities are of such stable nature and quality that they are expected to do well over a period of years in the general market. So long as the investor purchases the same securities over a repeated period of time making an equal cash investment each time the dollar averaging plan will work.

From the chart and tables shown on the following page one can see the results of what dollar averaging can do over the haphazard purchasing of the same stock over different periods of time. By purchasing under the dollar averaging plan the investor's total cost was much less than, the haphazard method of purchasing. This example presupposes that the investor invests $1,000. quarterly and reinvests all dividends at the first quarter applicable. Thus an investment of $73,000. is said to be worth $282,990. in 1947. If the investor invested the $73,000. haphazardly or all at once in any particular time the chances are he would have suffered a loss as it would have probably been unable to predict the right time to purchase.

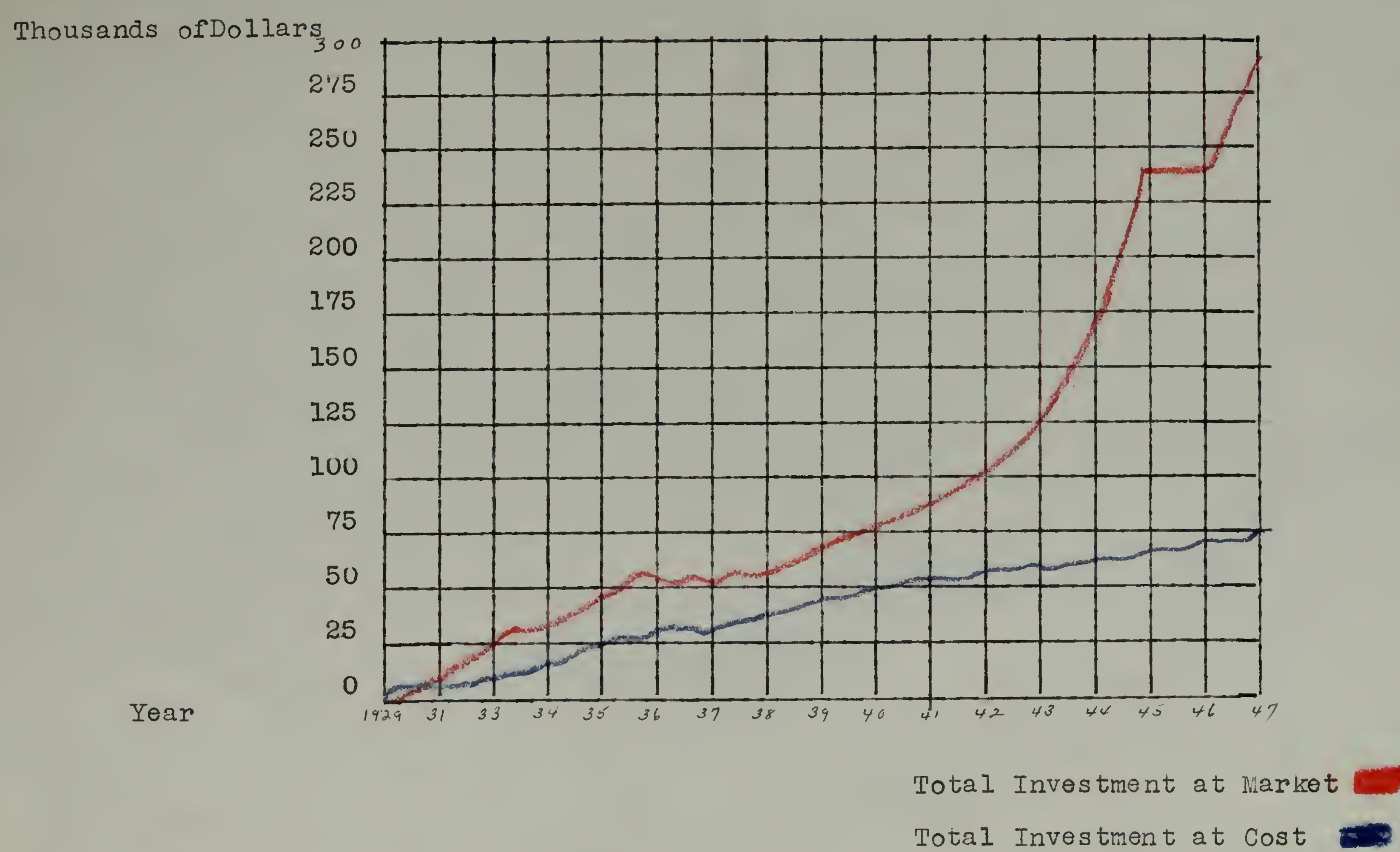
Investment companies that use the dollar averaging technique for the entire portfolio are very few. However, many investment trusts use the technique in regards to such stable securities as American Tel. & Tel. or public utility stock of high grade. Thus through this technique many first class securities can be bought over a period of time at reasonable fair cost.

Formula Timing Plan

There are several formula timing plans now in practice. These automatic timing plans are used so that they can provide the correct propotion of bonds and stocks in a portfolio during a bear market or bull market whatever the situation may be. It is a well known fact among expert

Chart 2

Results of Dollar Averaging in Lehman Corporation Common Stock



Source: Arthur Wiesenberger "Investment Companies 1948" Page 47

Table 2 The Use of Dollar Averaging with Lehman

	Annual Investment	No. of Shares Purchased	No. of Shares Held	Average Price	Average Cost	Total Investment At Cost	Total Investment Year End Market Value
1929	$ 1,000.	25	25	$ 35.01	$ 35.01	$ 1,000.	$ 749.75.
1930	4,025.	160	185	27.70	26.74	5,000.	3,410.95
1931	4,213.75	245	430	23,34	20.82	9,000.	5,434,60.
1932	4,395.25	335	765	20.26	16.89	13,000.	10,765.55
1933	4,650.	270	1,035	19.90	16.44	17,000.	22,809.20
1934	4,847.	210	1,245	20.51	16.86	21,000.	29,918.00
1935	5,123.91	195	1,440	21.40	17.29	25,000.	45,990.46
1936	5,899.58	175	1,615	23.12	17.92	29,000.	65,301.65
1937	11,892.37	310	1,925	25.06	17.07	33,000.	47,728.82
1938	6,303.50	265	2,190	25.01	16.89	37,000.	39,538.42
1939	5,775.	245	2,435	24.89	16.82	41,000.	55,621.27
1940	5,974.	280	2,715	24.59	16.56	45,000.	56,912.62
1941	7,190.15	330	3,045	24.35	16.07	49,000.	62,473.82
1942	7,891.25	390	3,435	24.04	15.43	53,000.	86,712.62
1943	8,345.	285	3,720	24.39	15.30	57,000.	112,608.97
1944	9,089.75.	280	4,000.	24.92	15.23	61,000.	154,243.97
1945	19,507.	445	4,445	25.92	14.60	65,000.	240,259.37
1946	32,589.75	690	5,135	27.50	13.42	69,000.	233,212.67
1947	27,593.	605	5,740	28.48	12.69	73,000.	282,99162

Source: Arthur Wiesenberger "Investment Companies 1948" Page 46

investors that during periods of bear market one should purchase stock and sell bonds which at the time are selling at premium. The opposite is true in a bull market everyone is expecting great profits during this inflationary period and as results people bid up the price of stocks and depress the price of bonds Thus the wise investor using an investment formula timing plan sells his stock and invests in bonds which are selling at low prices. The use of a timing plan allows an investor to take part of a profit in his securities, which at the moment are selling at a premium, rather than wait for the peak of the market and sell. True if he waited to sell at the peak his profits would be larger, yet very few investors can predict the turning point. Large investment trusts rather than try to predict the market turning point use the automatic timing plan being content with the results a ½ a loaf is better than none at all.

The various types of automatic formula plans are as follows:

1. Constant Ratio Plan
    - The Yale Plan
2. Variable Plan
    - The Vassar Plan
    - The Three Step Plan
    - The Seven Step Plan

<u>The Constant Ratio Plan</u>

This plan is based upon the following conditions:

1. What percentage of the total assets shall the common stock in the portfolio be?
2. What percentage of total assets shall the bonds in the portfolio be?
3. After the normal portfolio is determined above, the investment manager must determine how much the market must change before either the bonds or common stock are sold.

When the stock market moves upward to the predetermined percentage enough common stock is sold and bonds are bought to return the portfilio to its original ratio. An example of the constant ratio method is the Yale plan. This plan allows for a normal ratio of 30 percent common stock and 70 percent bonds or preferreds. Now if the market goes up so that the stocks are said to be 40 percent of the total value of the fund, enough common stock is sold so as to reduce the common to 35 percent of the total fund. With a decline in the market the opposite is true, when the common stock reaches 20 percent of the fund enough bonds are sold and common bought to increase the common position to 25 percent of the fund.

The constant ratio plan shows only a modest improvement over the buy and hold system unless very volatile securities are used. If the variations in ratio is not spaced apart far enough it merely guarantees the sales of some securities in a rising market and a purchase of some in a falling market.

A hypothetical case which is illustrated in Arthur Wiesenberger "Investment Companies 1948" shows the results of the constant ratio plan compared to the buy and hold system. According to this illustration an investor having $100,000. purchased $50,000. worth of stock of two investment companies under a 50-50 ratio. As one corocration the Carriers General Corporation is listed as a corporation with low leverage while the other corporation U. S. Foreign has a moderate leverage factor. The remaining capital of $50,000. is kept in cash for reserves. Now in the illustration belowwe see that when stock prices declined to 13 percent of the total investments purchases were made and when the securities advanced 15 percent sales were made. The eleven years results shows that the use of the current ratio plan over buy and hold system would have resulted as of December 31, 1947 with the constant ratio plan users with a portfolio worth $76,640. more than buy and hold system portfolio.

Eleven Year Results of Maintaining 50-50 Constant Ratio

		Carriers & General	U. S. & Foreign
Starting value	12/31/36	$ 100,000.	$ 100,000.
Total Value	12/31/47	123,450.	185,200.
Total Value of Buy & Hold	12/31/47	101,210.	128,800.
Difference in portfolio as of	12/8/47	22,240.	56,400.

Source: Arthur Weisenberger's "Investment Companies 1948" Page 51

The difference listed percentagewise use has resulted in a 22 percent gain for the constant ratio users in the Carriers General case while in the more speculative U. S. & Foreign it was a 44 percent gain for the constant ratio users.

Variable ratio method

The variable ratio plan a complicated but essentially more effective formula timing plan is based upon a predetermined market index. This index is considered as the normal, and the portfolio's composition is established by the management at this normal. When the market index either rises or falls to a predetermined new level the stock propotions of the portfolio are decreased or increased while the bond propotions are worked the opposite. In this way the ratio of stocks and bonds to the portfolio are changed only because of the market fluctuations of the index. There are said to be several variations of the variable ratio method. The following is a list of the various plans:

1. Vassar plan
2. Three step plan for income & growth
3. Seven step plan for capital growth

The Vassar Plan

This plan uses as its normal market level the median line of a predetermined 50 year trend line of Dow Jones industrial averages. This trend line shows an average growth of 2 percent per year and largely ignored in the compilation of the trend line the market period of 1941-45, because of

the war. Under this plan no stock is bought while the market level is above normal and no stock is sold while the market level is below normal.

In 1948 (1) the median line was said to be 153. At this level the stock fund was 50 percent invested in common stocks. When the level rose 10 percent above the average level, the common stocks were sold until at 203 the fund was 100 percent in fixed income securities. The opposite was true when the index dropped 10 percent below the normal, the common stock propotion was increased until at 112 the fund was 100 percent invested in common stock.

This plan has been criticized as being too conservative because in its 9½ years of operation to December 31, 1947 the fund showed a 27 percent gain compared with a 35 percent gain for the Dow Jones Industrial Average No stocks are bought under this plan while the market level is above the normal level, and no stocks are sole when the market index is below the normal This makes the Vassar plan differ from the following two plans which continues to purchase and sell common stocks at almost any level of the market.

<u>The Three Step Plan</u>

This plan and the seven step plan is designed to standardize the operation of the variable ratio plan and also meet the two investment objectives of income and capital appreciation.

Under the three step plan the management has used as a measure of the stock market action the Dow Jones Industrial Average from 1897-1948. From this measure of 51 years a trend

(1) Arthur Weisenberger "Investment Companies 1948 Page 94

line has been developed and projected over the next five years. The trend line has been split into three zones. The middle area of the zones is considered as the median line much the same as the Vassar median line except that under the three step plan the area of the median or normal is much wider than the seven step plan.

Thus by looking at chart 3 on the following page we see that the normal or median zone rests between 150 to 228. This zone is known as the middle area The area above 228 is known as the high area and the area below 150 is known as the low area. These 3 areas give rise to the term the three step plan.

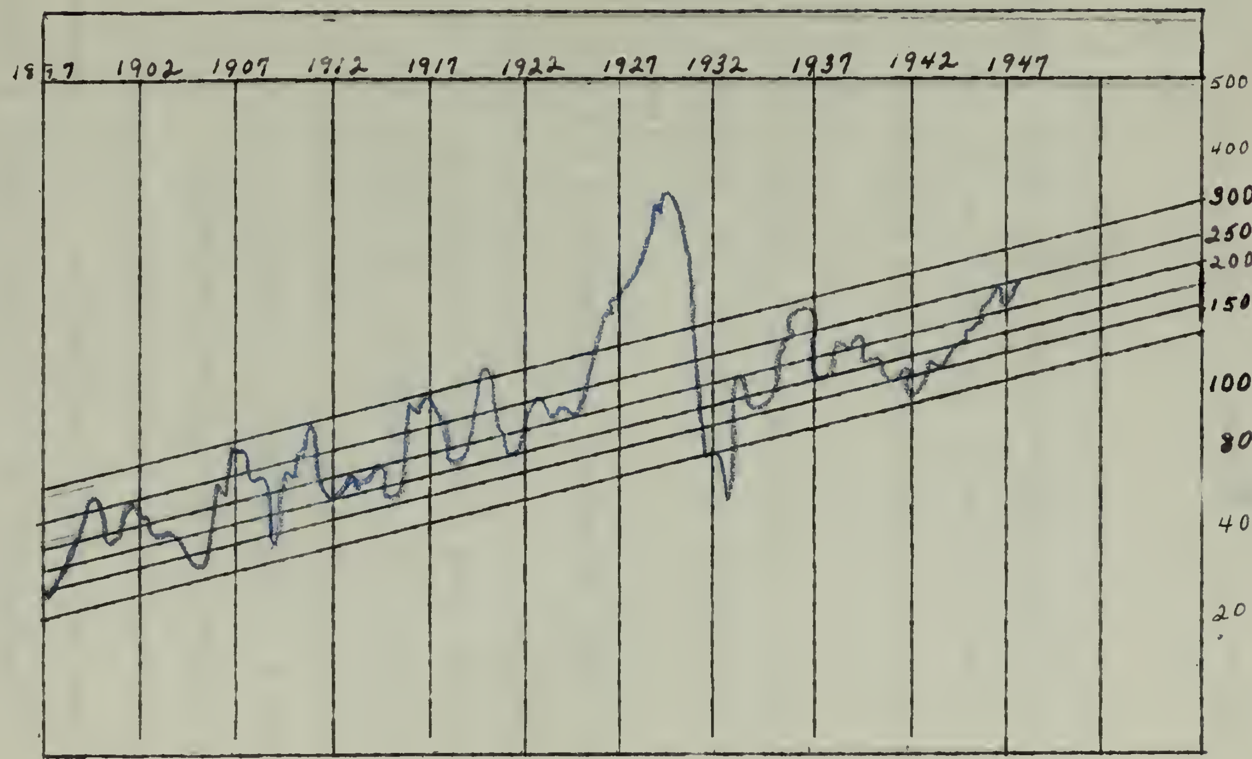
Under the three step plan half of the fund is invested in the different type of securities that are primarily suitable for income such as high and medium grade bonds and income producing stocks. This portion of the fund is not affected at any time by the operation of the plan.

The other half of the fund, however, is the important one It is split up into two units, Unit A which represents 1/3 and is composed of high grade bonds while Unit B represents 2/3 of the fund and is composed of low price bonds and low price common stocks, depending on the level of the average.

Under this plan when the market moves above the Dow Jones Industrial Average of 228 a maximum conservative position is sought. Unit A is composed of high and better grade bonds while Unit B is composed of low price bonds.

Chart 3

The Dow Jones Industrial Averages from 1897-1946



Source: "Successful Investment and Formulas" Lucille Tomlinson
Barron Publishing Company, 1947

However, when the Dow Jones Average moves downward from the 228 average to 172 the composition of the fund is as follows:

Unit A is changed from high and better grade bonds to cyclical preferred and common stocks while Unit B has no change at all.

If the market average moves to a still lower position say 149 and below, the fund composition is as follows:

Unit A is unchanged from its previous position found in 172 while Unit B is changed from low priced bonds to low priced stocks.

When the Dow Jones Average is between 150 to 227 which is known as the middle area position the fund composition is as follows:

Unit A has cyclical preferred and common stock while Unit B has low priced bonds. In a rising market the formula is worked the opposite to what has been previously explained.

This plan was originated and designed by the Keystone Custodian Funds. It is not possible to compute the results of this plan as its existence is too short at the present time. However, the permanent holdings of half of the fund in income securities without the need of withholding a cash reserve or its equivalent gives the user a plan that not only gives a fixed income but an allowance for capital appreciation in the portfolio.

The Seven Step Plan

The seven step plan derives its name from seven zones

that exist in chart 3. The zones were found by taking a logarithmic chart of Dow Jones industrials and drawing a straight line though the bottom of the bear markets since 1897 and another straight line through the approximate top of bull markets since 1897.(1)

This broad channel is split up into 5 zones which with the zone above and below the channel give 7 zones or the so called seven step plan.

When the Dow Jones industrial average rests between 173 and 198 the plan is said to be in its median or norman zone. In this zone the fund composition is said to be split 50 percent in stocks and 50 percent in bonds. A list below gives the seven zones and the recommended percentage of stocks and bonds to be held in each zone.

Zone	Dow Jones Indus. Average	% in Stocks	% in Bonds
1	Under 130	90	10
2	131-150	80	20
3	151-172	65	35
4	173-198	50	50
5	199-227	35	65
6	228-261	20	80
7	262-	10	90

Every 90 day interval the fund is examined and if the market average has changed zones the ratio of stocks to bonds is corrected for the zone that the market average is now in. Say for instance if an examination the market average was 169 instead of 175 then the stock to bond ratio would be changed from 50-50 to 65-35 respectively.

A hypothetical result of the seven stop plan for the 25 year period from 1922 through 1946 shows that a $1,000,000. fund operated in 1922 would have grown to $3,700,000. For a fund to have used the plan in 1937-1946 the fund would fid its stock portion increased by 70percent.(1)

Thus the seven step plan allows for greater apprecia-tion in capital with a sacrifice of a fixed income that the three step plan is assured of.

The variable ratio plan thus shows its advantage over the constant ratio because it provides a grater protection when the market is in the higher zones and greater opportunities when the market is in the lower zone to allow the investment managers purchase stocks at the lowest prices.

Who Use the Plan

As we said before the practical users of the ratio timing plans have been the college endowments groups and some investment companies. Keystone Custodian Funds recently admitted using two such plans of the variable ratio method technique. It is hard, however to determine how many companies are using formula timing methods to reduce the hazardous job of guessing the right time to buy or sell.' There are no available figures as investment companies are reluctant to give out this information.

(1) "Successful Investing Formulas" by Lucille Tomlinson published by Barron's Publishing Company 1947 Page 112

CHAPTER V
EXPENSES AND EARNINGS

In discussing the expenses of the investment companies one can briefly say that over a long period of time the companies as a group have shown a fairly steady average although the expense ratios of the individual companies have varied considerably.

An examination of the table on the following page reveals that expense ratios of eleven closed end companies for the period 1929-1948. The ratio of expenses to cash income for this period averaged 14.04 percent and the expense ratios of expenses to net asset revealed 70 percent. This tends to prove that the average expense ratios of the closed end companies have been rather steady.

However the importance of these expense ratios in the analysis of an investment company has been rather widely questioned. Alex Brock Stevenson says:(1)

> "Such ratios are of little value in appraising the value of management where it is results that count Besides anyone who will take the trouble to arrange a substantial number of companies in the order of their expense ratios for any given period will find they do not turn out to be arranged in the order of their investment performance."

Analysts in general believe that investment companies can operate effectively with the ratio of expenses to cash income and ratio of expenses to net assets to be 12 percent and 2/3 of 1 percent respectively.

Earnings

The earnings of investment companies are derived

(1) "Investment Company Shares" by Alec Brock Stevenson published by Fiduciary Publishers, Inc. of New York, 1947

Table 3

Average Expense Ratios of 11* Investment Companies

Year	Ratio of Expenses to Total Cash Income	Net Assets
1947	13.71%	0.62%
1946	12.96%	.51%
1945	13.14%	.44%
1944	12.02%	.54%
1943	11.79%	.60%
1942	11.31%	.73%
1941	11.38%	.88%
1940	12.90%	.78%
1939	15.39%	.69%
1938	18.88%	.67%
1937	14.01%	.99%
1936	14.20%	.60%
1935	16.24%	.55%
1934	16.67%	.75%
1933	19.12%	.82%
1932	15.07%	.99%
1931	13.32%	1.09%
1930	12.08%	.75%
1929	12.65%	.42%
Average ratio for the Period	14.04%	.70%

*The Companies are Adams Express, American European Securities, American International, Blue Ridge, Capital Adminis-

tration, Carriers and General, General American, Lehman Corporation, Niagara Shares Corp., Selected Industries, and U. S. and Foreign Securities Corp.

Source: Standard & Poor's Industry Survey-
Basic Analysis of "Investment Companies"
Oct. 8, 1948 Page 12-7

from (1) investment income that is composed of dividends and interest received from the securities held as assets and (2) from the gain in the sale of securities. During the 1930's the major position of earnings from most investment companies were derived from the capital gains made in the sale of securities. The reasons for this can easily be seen because at that time stock prices of many first class industries were ridiculously low. Thus when the market began to rise the sale of stocks produced large profits for the investment trusts. During this period the earnings of the trusts were reported to have averaged 8 percent of the companies' resources.

The trend since 1945 however, has been to lean towards investment income rather than capital gain. Table shows the average earnings gained from investment income of 30 closed end companies. The ratio of gross income to net assets was 4.6 percent while the Standard & Poor's average was 5.5percent. However, when one considers that few investment companies have their entire fund fully invested whereas the Standard & Poor's Index is calculated on a fully invested position the return is said to be very good.

Table 4

1947 Income Results of 30 Closed End Companies

Company	Gross Income 1947	Gross Income 1946	Net Asset Average in 1947	% Gross Income 1947	% Gross Income 1946
Adams Express Co.	$ 1,714,950.	$ 1,809,697.	$ 43,585,000.	3.9%	3.5%
American Cities Light	1,913,815.	2,274,625.	26,056,000.	7.3	6.7
American European Sec.	557,341.	581,851.	11,487,000.	4.9	4.3
American General Corp.	1,000,405.	1,378,618.	32,831,000.	3.0	
American International	760,786.	902,803.	20,695,000.	3.7	3.7
American Superpower	134,316.	326,222.	11,027,000.	1.2	2.0
Atlas Corp.	3,072,760.	2,750,835.	67,341,000.	4.6	3.4
Blue Ridge Corp.	1,742,800.	1,911,643.	36,236,000.	4.1	3.9
Capital Administration	363,612.	320,046.	7,623,000.	4.8	4.0
Carriers & General	390,099.	387,554.	7,996,000.	4.9	4.6
Consolidated Investment	1,650,975.	1,242,499.	25,614,000.	6.4	4.5
Equity Corp.	446,917.	2,450,258.	21,048,000.	2.1	9.5
General American Inv.	1,597,370.	1,527,714.	36,587,000.	4.4	4.0
General Public Service	221,055.	215,423.	4,925,000.	4.5	3.9
General Share Holdings	1,061,865.	476,009.	20,941,000.	5.1	4.5
Lehman Corp.	4,225,119.	3,759,415.	98,722,000.	4.3	3.5
National Aviation	186,847.	237,177.	7,458,000.	2.5	2.2
National Bond & Share	447,057.	426,243.	10,086,000.	4.4	3.8
Newmont Mining Corp.	4,345,843.	2,627,681.	73,933,000.	5.9	4.1
Niagara Share Corp.	779,571.	814,729.	20,926,000	3.7	3.4
North American Invest.	281,951.	231,619.	5,645,000.	5.0	3.8
Pacific American Invest.	909,920.	774,364.	15,626,000.	5.8	4.5
Penrood Corp.	2,667,435.	1,878,438.	47,415,000.	5.6	3.8
Petroleum Corp.	538,895.	476,475.	11,637,000.	4.8	4.5
Railway & Light Sec.	489,222.	492,665.	10,195,000.	5.1	4.3
Selected Industries	2,297,334.	2,098,002.	44,488,000.	5.2	4.4
Tri Contenental Corp.	2,481,528.	2,028,917.	48,852,000.	5.1	3.8
United Corporation	4,656,443.	3,061,095.	111,685,000.	4.2	2.7
U. S. & Foriegn Sec.	1,631,128.	1,407,403.	50,388,000.	3.2	2.6
U. S. Industrial Sec.	1,628,950.	1,373,952.	36,409,000.	4.5	3.7
Combined Companies	$ 44,023,345.	$ 40,743,942.	$ 967,435,000.	4.6	3.8

Dowe Jones Composite Stock 5.6% 4.4%
Standard & Poors 90 Stock 5.5% 4.2%

Source: Arthur Wiesenberger, "Investment Company" Page 98

CHAPTER VI
INVESTMENT ACCOUNTING METHOD

The analysis of investment trust accounting methods is important to any wise investor. The lack of uniformity in the method of calculating any profit or loss on the sale of securities has been one of the main problems. There are three methods that are used for calculating the results of completed security sales, these are: (1)

1. The first in first out method
2. The specific cost
3. The average cost.

The first in first out method assigns the cost of the security sold to those identified as being first acquired. The remaining securities are valued at the cost of the goods most recently acquired. The advantages of using this method are two fold. First by charging the security with those identified with the first purchases the company is trying to get the benefit of the capital gain rule which states that 50 percent of any capital gain or loss held more than six months is allowed to be reported. Second in times of depression the use of the first in first out method tends to show a larger profit.

The specific cost method itemizes the cost of each 100 share unit sold and assigns to each share the actual cost of that share. This method requires extensive records to be kept as to actual cost of the shares and as to the identification of the date of purchase to determine whether or not

(1) Loftus, John A. "Investment Trust Management," John Hopkins Press Page 20

the sale is a long or short term capital gain or loss.

The average cost method is computed by taking as cost the average purchase price of all units of that one security now held by the investment company. This method eliminates detailed records of the cost of unit purchases and the date purchased.

Different trusts use these different methods although in the long run no matter what method is used the end result will be the same. However, what does make a difference has been the practice of some trusts to change their methods regarding inventory from year to year and so distorting the long run picture.

Classification of Accounts

Investment trust accounts are reasonably few in comparison with other large corporations of similar size. A breakdown of an investment company balance sheet reveals the following accounts: Cash and Government Securities, Bonds, Preferred Stock, Common Stock, Investments in Subsidiary, Current Liabilities, Bonds Payable, Preferred Stock, Common Stock and Surplus Reserves.

Cash and Government Securities include the total cash on hand or deposited at banks and all United States Government securities held by the investment company. These government securities may be readily liquidated without too much loss in principal and because of this are considered in the same light as cash.

Bonds usually includes all bonds held by the investment companies. They may be debts of public utilities, private industry, or of states or local municipalities. Some of these bonds may be mortgage bonds or debentures such as the American Telephone and Telegraph that lack any security because of their fine record in the past.

Preferred stocks are assets of investment companies in that they are part of their portfolio. The preferred stock may be composed of public utility or private industry. Preferred stock usually guarantees holders that in the event of liquidation unless otherwise stated the preferred stockholders have prior rights after all debts have been paid. Preferred stocks are assumed to have prior rights to all dividends declared. Unless it is otherwise stated in the charter, courts have ruled that all preferred stocks are cumulative meaning before any declared dividend is paid to common, preferred stockholders must receive their share of the current dividend plus any unpaid dividends of prior years.

Common Stock represents the basic ownership in corporations. Generally common stockholders are assumed to have control over the corporation by their power of voting. Holdings in common stock of the investment companies are split up into public utility industrial, railroads and financial industries.

Investment in subsidiaries represents control by investment companies of certain companies. The general

Policy behind this investment is to invest in these underpriced situations and through active management help the companies back on their feet. Once this is accomplished the investment company partially or fully withdraws from the company. For example Atlas Corporation sold 400 thousand shares of R. K. O. to Howard Hughes and withdrew from management control of the firm.

Current liabilities of investment company may be classified as current debts of the company that must be paid within the fiscal year. It is said to be composed of notes receivable, or bank loans which are issued for a short space of time ranging from 60 days to 1 to $1\frac{1}{2}$ years. The interest cost is usually very low running from 2 to 3 percent per annum.

Bonds Payable are fixed liabilities that are payable over a period of time that is longer than the fiscal year. Interest rate on bonds usually average from 2 to 2 7/8 percent. Open end investment companies are forbidden to have a funded debt.

Preferred Stock and Common Stock were explained before except that now we are talking about the investment company's stock instead of the common and preferred stock of other companies that the investment companies held.

Ratio Analysis

There are certain ratios that the analyst uses in his examination of investment companies. These are a break-

down of the total assets into the several classes: ratio of cash and government securities to the total assets, preferred stock to the total assets, bonds to the total assets and common stock to the total assets. As to what percentage constitutes the acceptable standards in each case it is hard to say because of the ratio of total assets changes during the business cycles. For example the New England trusts of all types that represent something like 45 percent of all investment trusts[1] in the United States increased their cash and government securities from 4. percent in 1947 to 3.8 percent in 1948. The bonds decreased from 17.7 percent to 12.7 percent and preferred holdings from 14.8 percent in 1947 to 8.8 percent in 1948, while common stock holdings remained the same at 70.5 percent. These ratios are the most important ones on the analysis of financial statement coupled with the leverage ratio that may exist. The leverage factor tells what the percentage gain or loss in total assets the common stockholders receive through the use of bank loans or a funded debt. This ratio is important to an analyst in order to determine whether or not the company is too speculative or not. The earning power ratio of the investment trust companies is important and is determined by dividing the earnings or investment company by the value of the stock. A ratio of 16 to 20 times earnings has been considered by many as a reasonable return.

(1) Federal Reserve Bank of Boston "Monthly Review" October 1948 Page 7

Other important factors to be analyzed are the increase in net assets of the year that was described in the chapter on Management Analysis; the composition of income is very important as it reveals whether the trend in the industry is towards investment income or capital gain.

Of all the ratios and other factors analyzed the most important is the breakdown of the portfolio composition and the analysis of earnings as they indicate the trend of the investment policy and the results of such a policy.

CHAPTER VII
REGULATIONS OF INVESTMENT COMPANIES

Background to regulation

In looking back at the past, one fails to wonder why people did not demand the control of the past reveals that as far back as 1928 early warnings were given to the public about the need for regulations. Such disclosures were sent out in 1928 by chairman Louis T. Mc Fadden and Representative Wingo of the House Committee on Banking and Currency in a resolution calling for the regulation of investment trusts.(1) Weaknesses such as the unloading of securities by affiliated houses on investment trusts, high pressure salesmanship on small investors, failure to diversify, inadequate accounting methods, over speculation and secrecy of the portfolio composition were pointed out in the need for the regulation of investment trusts.

The National Association of Securities Commissioner in 1927 authorized the appointment of a committee on investment trusts which after a year recommended that the state securities laws be tightened to protect the purchasers of trust securities from defective or fraudalent issues by establishing standards as to type of securities issued, qualified personnel, minimum investment, protective charter provisions, and adequate and honest information to prospective purchasers as requisites for permission to sell securities within the states.(2)

(1) HARWOOD AND BLAINE, "Investment Trusts and Investors Funds" Page 31
(2) NATIONAL ASSOCIATION OF SECURITIES COMISSIONER, "Report on Investment Trust" 1929.

However, the investigation that caused the most far reaching effect on the public mind was the New York Attorney General's report.(1) As a result of his survey, Mr. Ottinger recommended legislation be enacted to vest the control over investment trusts in the State Banking Department with powers to withhold corporate charters and to prescribe and examine accounts and reports. This was designed to prevent improper persons from organizing and managing trusts and to promote a general adherence to practices followed by the British Trusts. These practices included reasonable costs of raising capital, a ban on buying on the margin, short selling, pool manipulations, regulation of management practices considered unethical; publication of the market values of the portfolio. Yet, again it happened, despite Ottinger's warning of correcting the trust "While the horse is still in the barn," the bill failed to pass.

However, the New York Stock Exchange was not sleeping during this time and as far back as 1924 it passed a resolution threatning to punish any member found to be associated with any investment trust company that did not effectively protect the investors interest.

In 1929 when investment trust securities were allowed to be traded on the exchange the following information had to be filed by the firms:

1. Identity of Management
2. Amount of compensation paid to management
3. Organization expenses

(1) Albert Ottinger and T. J. Shear "Investment Trust Report"
(2) New York Stock Exchange-Durst "Analysis and Hanbook of Investment Trusts" Page 369

4. Funded debt
5. Commission charges on portfolio purchases
6. Protection afforded to non-voting stock
7. Publicity of portfolio and market values
8. Auditor certificates
9. Consolidated statements
10. Dividend payments

The effect of these listing requirements for admittance was not so great because many companies sold large amount of securities in the over the counter market rather than submit to regulation by the exchange.

Finally the poor results and malpractices of some investment companies during the period of the thirties coupled with the growing influence of government control in the industry led to the establishment of the Commission on Investment Trusts and Investment companies which conducted an exhaustive survey costing over $5000,000 covering studies of 1272 invest trusts companies for a period of 9 years.

This report found almost 8 billion dollars invested in securites of all types of investment trusts from 1927-1935. Of this amount 3 billion dollars was lost. The report further revealed that of 1272 investment companies of all types only 559 investment companies were still in existence in 1936. Thus a casualty rate of 56% was too high said the Securities Exchange Commission.

Although the need of legislation to bar unsound practices was recognized by the leaders of the industry as well as by the Securities Exchange Commission, there was a considerable difference of opinion between the two groups about the nature and extent of restrictions which should be placed upon investment trusts. There was a large measure of cooperation between the two from thebeginning of the Congressional hearings on the regulation of trusts. Conferences were held with members of the investigating committee and of 100 trust companies. After completion of the investigation the Congressional Committee received the proposals and recommendations of the Committee of National Investment Companies which represented over 33 closed and open companies, with assets estimated at over 2/3 of a billion dollars.(1)

When the bill was first presented to the house the members of the investment trusts cried that the legislation went much further than necessary to prevent future abuses; that it was unneccessarily restrictive, and that its provisions were vague and uncertain. Because of these objections raised by industry the Senate House Committee sat down with representatives of the industry and the results of this cooperation was the Investment Company Act of 1940.

Invest. Company Act of 1940

The act defines as an investment company as an individual

(1) Business Week May 12, 1940.

or company that has capital issues outstanding that is primarily invests in securities. The investment companies are divided into three principal classes:

1. Investment trusts of face amount certificates
2. Unit investment trusts
3. Management company

The first type company issues certificates which provide for periodic payments during an extended period of time with the understanding that a certain agreed sum will be paid to the certificate holder on the maturity of the certificate.

The second type, the unit investment trusts is organized under a trust indenture or similar contract having no directors and issues only redeemable securities each of which represents an undivided interest in a block of specified securities.

The third type, the management company is defined by the act as, "any investment company other than a face amount certificate company or a unit investment trust. " The management company is further divided into open end and closed end companies. The open end company agrees to redeem its securities and has no restriction as to issuance of new securities. The open end company agrees to redeem its securities and has no restriction as to iffuance of new securities. The closed end is the opposite, it has a fixed total capitalization and does not agree to redeem its securities. The management company is further divided into diversified and undiversified companies.

Diversified companies are said to have 75% of its assets in cash and securities, and the investment in any one company does not exceed 5% of the trusts assets or 10% of the issuing company voting securities.

The regulation of theinvestment companies is accomplished through a provision which does not force the investment trusts to register with the S.E.C., but by for idding unregistered companies the use of the U.. S. Mail for the purchase or sale of securities the companies are compelled to register.

Registration Requirements

The registration requirements of the act require all registered companies to disclose their policy with respect to the type of comany they plan to follow. This policy can not be changed unless stockholders have consented to the change. This prevents management from damaging the interest of stockholders through manipulative practices. The act does not guarantee to regulate investment policies; it only requires that full disclosure of information be made to the public.

The following information is required with the filing of the registration statement:

1. Statement of the policy
2. Information on diversification of investments
3. Participation in underwriting activities
4. Purchases of real estate
5. Borrowing money
6. Issuance of senior securities
7. Portfolio turnover.

Failure to file a correct statement will result in suspension of the company's registration and its operation,

One of the principle parts of the bill is the elimination of a registered company's management of certain individuals and organizations. Under this provision the board of directors shall not have more than 60% of its members composed of investment advisers or officers of the investment company. No officer or trustee, director or employee of the trust can be associated with the underwriting of the investment company's securities, unless, a majority of the board of directors is not connected with the principal underwriter. This provision was passed to prevent the abuse of maxiumum commissions and the use of investment trust funds for officers' and directors' private profit.

Interlocking relationship with commercial banks are also controlled. No investment company can have as a majority of its board of directors, officers or directors of any bank. Existing relationships were not disturbed but no further increases were allowed.

Transactions between affiliated persons to aid the person dispose of certain issues of securities are forbidden.

This closed the so-called self dealings between investment bankers and investment trusts.

Officers, directors and stockholders holding more than 10% of any class of outstanding securities of closed end companies were required to report monthly on completed

transactions in their investment company securities and were made liable for any profits made on those securities held within six months.

Registered companies were prohibited from carrying on the following activities:

1. Purchasing on the margin
2. Participating in joint trading accounts
3. Pyramiding of investment companies
4. Changing the investment policy of the company without the consent of the majority of stockholders
5. Establishing a trust with a net worth less than $100,000.

Security Holders Rights Over Management

Under the section in this act voting trusts were abolished and "Circular Ownership" which enabled management to retain control of two or more companies by having each company own large blocks of voting securities in other companies was prohibited. The proxy rights of security holders and its procedure was placed under the control of the S.E.C.

All contracts with advisory services had to be in writing and approved by a majority of the voting stockholders. These contracts were required to be specifically approved each year by the directors an security holders. They were terminable without penalty upon 60 days notice by the company upon action of the board of directors.

All directors had to be elected by the majority of voting stockholders. No common stock could be issued below its net asset value to outsiders without the consent of the stockholders.

This prevents the dilution of existing stockholder's equity for the benefit of outsiders. All closed end securities must be repurchased through the medium of open market and thus prevents any manipulations or malpractices being carried out by management heads.

The Capital Structure

The minimum capital or net worth of a registered investment trust must not be less than $100,000.

Funded debts created by closed end companies must be covered three times by asset while preferred stock must be covered by twice the amount of assets. Payments of cash dividends are forbidden if the proposed payment reduces the asset coverage below the minimum requirements stated above. In the event asset coverages decline below 100% holders of bonds of the company may be entitled to elect at least a majority of the directorate until the asset coverage is 110%. Preferred stockholders have the right to elect at least two directors at all times.

Another step towards a consevative capital structure is the provision forbidding the purchase of more than a normal percentage of voting securities of other investment companies. Thus no company will foolishly use its assets

trying to gain control of another investment company. However if control did exist before the act it is allowed to continue to do so.

Open end companies formed after the act are limited to a single capital structure. However, it may be allowed to secure bank loans from time to time, while funded debts are strictly forbidden. Any companies having a multiple capital structure before the act was published were allowed to remain. Yet, any refunding of senior securities by such companies must be refunded by bank loans. This law has eventually caused many open end companies to replace their multiple capital structure with a single capital structure.

Stock Warrants

Because of the abuse of the option warrant by the investment managers, the act of 1940 makes it unlawful to issue warrants except to security holders of the company and for a period not longer than three months.

Dividend Payments

Dividend payments may be made only from the following sources:

1. Company's accumulated undistributed net income
2. The company's net income for the current or preceding fiscal year.

Trusts may not declare a dividend from any other source, unless, the facts are fully disclosed. The regulation on cash dividends were mentioned before.(1)

Financial Statement Requirements

(1) See Chapter on Dividends

All registered investment companies must file comprehensive reports with the S.E.C. and send reports to the stockholders, at least twice a year. These reports shall contain a balance sheet, income statement which contains a breakdown of the catogory of income and expense accounts that represent more than 5% of total income and expense, an itemized surplus statement, the composition of the portfolio as to quanity and market value; compensation paid to management, list of all purchases and sales of securities during the fiscal year. All reports must be prepared by an independent certified public accountant who shall have been chosen by the majority of the board of directors not having any affiliation or relations with other companies and are not officers or investment advisers. Failure to comply with these requirements brings heavy penalties similar to that passed by Securities Act of 1933.

The Results of S.E.C. Regulation

The investment act of 1940 although in the beginning aroused many bitter controversies between congressional investigators and leaders of the industry, they all now agree it has:

1. Discouraged the irresponsible elements who formerly used it as a means of speculation from entering the field
2. Confirmed sound fiduciary standards of conduct in the field
3. Led to increased public respect and confidence in the entire field.

State Regulations

Prior to the passage of the Investment Company Act of 1940 the majority of States had no laws that specifically regulated investment companies. All investment companies that sold security issues in the States were required to file the same information that industrial companies selling similar securities were required to file.

However with the passage of the Investment Act of 1940 by the Federal Government three states, Ohio, Minnesota, and New Hampshire passed what is now known as the "Q" regulations. These Regulations went to the heart of the frame work of investment companies that were to be allowed to be qualified in these three states. Many of the Regulations have been included in the Federal Act, but also a good many of the requirements of the Q-3 Regulations were not. Thus one who wants to qualify or form an investment company with the purpose of qualifying for sale in Ohio must adhere to Q-3 Regulations.

The Q-3 Regulations

The Q-3 Regulations were originally proposed by the National Association of Securities Commissioners at their Convention held in 1939. The Q-3 Regulations were adopted by Ohio during the same year. The regulations proposed the following:

1. All investment company officers and directors are forbidden to deal on behalf of themselves with any corporation or partnership that the officers or directors of the investment companies have a financial interest in.

Qualifications to this rule allows an investment company to deal with a brokerage house whose partner may be an officer of the trust providing the brokerage fee is normal and usual.

2. The retention of securities issued by an issuer whose officers or directors or security holders of a large majority are also officers or directors of a large majority are also officers or directors of the investment company is prohibited in the following cases:

1. One director having official connection with both companies owns more than ½ of 1% of the shares recently purchased by the investment company.

2. One or more directors having connections with both companies privately, own more than 5% of such shares that the investment company purchases.

3. Officers and directors of the trust are forbidden in participating in a long or short position in the investment trust stocks.

4. Trust assets are forbidden to be loaned to the investment company's sponsor, manager or officers.

5. Custodian requirements be set up with regards to the investment securities in the portfolio, cash proceeds, received from the sale of securities held by the trust, or from trust issues, or investment income.

6. The requirements for the custodian are that the bank or trust company acting as such must have a capital of $2,000,000or more. The custodian is required on relinquishing its duty to find another company capable of carrying on as a custodian;

turn over all the trust assets to such a custodian and in the event no successor is found the investment company shareholders be notified. In any event the custodian requirement still stands and the investment companies must have one if it is to continue to operate in Ohio.

7. Custodian must keep strict account of the investment securities,cash proceeds received in the sale of investment company portfolio, or investment company securities, or investment income in the form of dividends and interest.

8. The method of determination of asset value and liquidating value of the trust be set up as follows:

1. Take the net asset value and divide it by the number of investment company shares.

9. Investment companies are prohibited from purchasing a simple issue that represents more than 5% of the total investment company's portfolio. The companies are further prohibited from holding different issues of securities of a same company that represent ore than 10% of the investment company's portfolio.

10. The purchasing of other investment trust shares by an investment company must be carried out through open market operation and the purchase cost paid to the broker must be normal.

11. Investment trusts can not borrow an amount in excess of 10% of its gross assets valued at cost.

12. Investment trust shares shall have an unrestricted transfer privilege.

13. Trust officers and directors are forbidden to use trust assets for buying on the margin.

14. Investment companies are prohibited from purchasing issues of securities from a corporation that has less than 3 years continuous existence.

15. No management contract of a trust will be allowed to be amended, transferred, assigned, sold or pledged without a consent from the majority of shareholders of the investment company.

16. The removal of more than one half of the officers or directors of a trust shall require a special meeting of stockholders for the purpose of electing new officers or director.

17. The maximum selling or loading charge of investment company shares shall be 9% of the net asset value.

18. The maximum fee for repurchasing investment company shares shall be 1% of the liquidating value.

19. Trusts must redeem shares not more than 7 full business days after tender and at the asset value on the close of the day the redemption was effected.

20. The investment companies must file the following reports which must contain an independent certified public accountant's certification:

1. Operation of the fund
2. Balance Sheet
3. Profit and Loss
4. Statement of amounts paid to security dealers, legal counsel, transfer agent, custodian, and disbursing agent.

All such reports shall be sent to states where the investment companies securities are sold.

21. All dividends paid out of capital gains shall be revealed to the investment company shareholders and the basis of calculation set forth.

The Effect of Q-3 Regulations

In the Q-3 Regulations although only adopted by 3 states has forced almost all the investment companies to adhere to them very rigidly in order that they may be allowed to operate in Ohio. The regulations along with the Federal Act has further strengthen the investment companies by casting out the badly managed companies, because where the Federal Act seemed to stop the Q-3 Regulation seemed to carry on.

The National Association of Securities Commissioners has expressed a desire that certain regulations be applied to sales literatures used by investment companies. The Commissioners want:

1. No predections be made with regard to future value of investment company shares.

2. Comparisons with general market averages should be representative and consistent; for example, a high-grade bond fund should not be compared with a common stock average, and the yardsticks for measuring performance should not, in the absence of a major change in investment policy, be changed for the sake of convenience or temporary advantage;

3. The periods used for making comparisons should not be selected on the basis that they permit more favorable comparisons than other periods. Comparisons from year to year, or covering an economic cycle, or for periods of particular significance to an individual company in relation to its internal affairs, do not, generally speaking, seem objectionable. The most informative test of management performance would seem to be one which is based on a period when the market for comparable securities was at approximately the same level at the beginning and at the end, having been up and down in the interim;

4. A clear distinction should be made for all purposes between distributions from net investment income and those from capital sources. The Commissioners recognize the importance of distributing capital gains for tax purposes, but such capital gains distributions should be clearly identified as such;

5. Representations or implications as to yields or returns should be based solely upon net investment income.

CHAPTER VII
CLOSED END COMPANIES

Closed end companies are companies that have no provisions for day to day issuance or redemption of the companies' stock. The capitalization of closed end companies is fixed and usually may be bought on the Stock Exchange. This chapter covers a detailed discussion of the distinguishing characteristics of the closed end companies which are as follows:

1. Capital structure
2. Discount of the investment trust stock
3. Leverage factor
4. Investment policies

The capital structure of many closed end companies generally takes the multiple capital form. In a study made from 34 leading closed end companies in 1948 (1) it was found 16 out of 34 companies or 47 percent were said to have a multiple bond and capital stock structure. Of these 16 companies, the bond liability was further split into 3 groups (1) debentures, (2) notes payable and (3) bank loans. The total debt of the 3 groups was $61,129,000. of which the debenture group had 59.3 percent of it, the notes payable had 14.4 percent and the bank loans 26.3 percent. The study further revealed that companies were trading on their equity for only 17.6 percent of the total liabilities and capital while 82.4 percent was provided in the form of common and preferred stock. As a result of this ratio the average closed end company is said

(1) Arthur Wiesenberger, "Investment Companies 1948" page 189

to have a favorable capital structure.

Discount of Closed End Stocks

The closed end companies for the last 20 years have suffered a great disadvantage in the form of discount of stocks. Many of the closed end companies stocks have sold at discounts meaning they have sold for less than their liquidating value if the firm was dissolved at the moment of the sale. Discounts have varied widely from 20 percent to 41 percent in 1941. There is no set pattern at deducing the amount of discounts from year to year because the basic reasons or causes for the discounts that existed after 1929 were:

1. Large drop in net asset value of the investment trusts
2. The failure of many investment trusts to pay a dividend for over several years
3. The lack of faith in investment trusts by the investment public.

Because of this many investment trust shares were selling at a discount which enabled Floyd Odlum's Atlas Corporation to buy all the shares of many investment companies at a discount and liquidate the firms' asset and pocketing the difference as profits.

An examination of the table on the following page will show that over the 7 year period 1941-1948 the average closed end company sold at discounts ranging from 41 percent in 1941 to 29 percent in 1947.

Table 4a Showing the Discounts of 24 Closed End Companies

Company	1947	1946	1945	1944	1943	1942	1941	1936
Capital Administration	52%	48%	40%	41%	50%	40%	56%	38%
Niagara Share	49	46	37	40	48	62	65	40
Pennroad Corp.	42	22	5	32	33	47	56	36
U. S. S. Foreign Sec.	41	37	34	22	*	*	*	37
Newmont Mining Corp.	40	37	21	26	22	36	35	9
TriContinental Corp.	38	39	35	31	24	*	*	28
American International	37	41	31	34	31	39	47	27
Adam's Express Co.	35	39	32	38	40	45	57	32
Failway & Light Sec.	35	32	32	38	40	45	32	33
Pacific-American Inv.	34	49	25	*	*	*	0	0
Carriers & General	33	38	26	29	43	41	46	37
Equity Corporation	32	14	*	21	*	*	*	28
General Shareholding	31	36	4	4	*	*	*	4
American European Sec.	26	30	33	36	47	*	7	36
American General Corp.	26	7	24	32	49	41	53	30
Atlas Corp.	25	33	25	30	40	46	41	20
General American Inv.	25	27	13	16	31	30	42	27
National Aviation	25	19	11	28	41	49	52	13
Blue Ridge	22	16	*	*	7	*	*	13
Petroleum Corp.	22	22	14	20	6	16	24	25
Consolidated Investment Tr.	18	21	21	23	26	24	32	46
National Bond & Share	15	18	20	20	20	18	34	17
American Cities	4	0	15	*	*	*	*	3
Lehman Corp.	0	14	7	14	21	15	24	13
Ave. of Discounts	29%	29%	23%	28%	33%	37%	41%	26%

*Premium

Source: Arthur Weisenberger "Investment Companies 1948" page 94

This shows that the average discount of closed end companies has been slowly closing, meaning that the investment public must be investing more and more in investment company securities. Standard & Poors Industry Survey dated January 1, 1949 claims the reason why the discount has narrowed is because of the investment companies' creditible record for the last 10 years and because of their entrenched position which has resulted through the retirement of bank loans, funded debts and preferred stock during the past several years.

Leverage Factor

Leverage is a financial term which means the amount of borrowed funds used by an investor for the purpose of investment speculation. A person trading on the margin is using leverage when he borrows 25 percent of the investment. In the investment trust field the leverage factor is brought about through the use of debenture bonds, notes payable or bank loans or preferred stock. When leverage funds are invested in securities and bring back a large return over and above the liquidation value of the leverage funds: then the surplus belongs to the common stock. Thus an illustration below will show how the leverage factor can be a very lucrative investment to the common stockholder.

We have company A that has the following:

	Situation A	Situation B	Situation C
Total Assets	$10,000.	$15,000.	$5,000.
Preferred Stock	8,000.	8,000.	8,000.
Common Stock	2,000.	7,000.	3,000.
Total Shares Common Outstanding	100	100	100
Value of common per Share	$20.	$70.	$0.

In this illustration we see that a corporation under situation B finds that while the total assets were increased 50 percent, the common stock was increased 350 percent through the use of preferred stock as a leverage factor. The same can be said for the opposite picture supposed in situation C the asset value dropped 50 percent, it would wipe out the common stock equity and impair the preferred stock equity by a reduction of 37½ percent.

Leverage is calculated by the following method: (1)

1. Deduct from total assets all cash and high grade bond investments and non speculative preferred stock that does not move with the market
2. Divide the total number of shares of common outstanding into the difference found in step one this gives the volatile working assets per share.
3. Divide the working assets per share figure by the price of the stock and one will have the leverage factor.

Thus if the working assets per share are said to be $20. per share and the stock is selling for $10. the leverage factor is said to be 2:1.

Leverage shares of closed end companies are classified in four categories: (1) Low leverage, (2) medium, (3) High leverage and (4) extreme leverage. Low leverage is said to exist where not more than 20 percent of the total assets are in senior capital securities. This type of

(1) Arthur Wiesenberger "Investment Companies 1948" page 37

security is usually held by investors for its income plus the chance of a moderate appreciation in principal. Medium leverage shares exist when senior securities are no more than 30 percent of the total assets. This type of security appeals to the cautious type of speculator who wants a fast moving item but not too fast ahead of the market. The high leverage type of security has senior capital which is 40 to 75 percent of the total assets. This type of security is very susceptible to the market fluctuations and it is strictly used by speculators for its leverage factor. The leverage factor for this type of security ranged from 4 to 1 to 8 to 1 for the year ending 1948.[1] The most extreme leverage group usually finds itself without asset value at all. The prime reason people invest in this group is the potential participation in the working assets of the company. It provides a greater participation in the company's working asset then the high leverage shares do. However, one thing should be kept in mind a large deficit values does not mean high leverage exists or neither does low prices indicate the existence of high leverage. Because of the multiple capital structure the leverage factor exists and gives the closed end companies a distinguishing characteristic.

Investment Policies

Investment policies of closed end companies may run from the very conservative type which includes only high grade

(1) Arthur Wiesenberger, "Investment Companies 1948" Page 39

bonds in its portfolio to the speculative type that invests entirely in common stock or special situations. There are several types of investment policies: (1) the fixed fund type, (2) the specialization type that invests in one special industry such as aircraft or public utilities, (3) the management or common stock type and (4) the combination of common stock and bonds in the portfolio, (5) the special situations that offer larger profits than normally received by investment trusts. Examples of these special situations are Atlas Corporation's investment in other investment trusts shares for the purpose of liquidating them at a profit, or the investment by many investment companies in defaulted railroad bonds during the period 1939-1944 with the eventual liquidation of most of them by 1947 at large profits to the investment trust companies.

The investment policies of the closed end companies vary according to the four groups or types that I mentioned. However, the overall performance of 23 companies shown in the opposite table was that average improvement in these investment companies portfolio was a gain of 62.39 percent, while Standard and Poors 90 stock index only showed a 55 percent improvement. This list of the twenty three companies also shows that they range from the most conservative to the most speculative of the closed end companies. Thus the investment policies of the closed end investment companies has been very good for the last 11 years.

Table 5 Showing the Overall Investment Performance of Twenty Three Closed End Companies From the Period 1936-1948

Company	Average Gain in Portfolio	Standard & Poor's 90 Stock Index Gain
Adams Express Co.	63%	55%
American Cities Power & Light Corporation	81	"
American European Sec. Companies	92	"
American Inter. Corp.	51	"
Atlas Corporation	78	"
Blue Rindge Corp.	67	"
Capital Administ. Co.	49	"
Carrier & General Corp.	46	"
Consolidated Invest. Trust	127	"
First York Corp.	57	"
General American Invest. Co.	125	"
General Public Service Corp.	73	"
General Share Holding Corp.	55	"
The Lenman Corporation	85	"
National Bond & Share	51	"
Niagara Share Corp.	15	"
North American Invest. Corp.	50	"
Pacific American Invests. Inc.	51	"
Railway & Ligh Securities Co.	45	"
Selected Industries	65	"
Tri Continental Corp.	45	"
U. S. & Foreign Secur. Corp.	89	"
U. S. and International Securities	73	"
	62.39%	55%

Source: Arthur Wiesenberger "Investment Companies" 1948
Page 89

CHAPTER IX
OPEN END COMPANIES

Background to Open End Company Stock

Before the characteristics and past performances of open end companies stock are revealed a brief outline of open end companies' development is needed. The first open end company was originated in Boston in the early twenties. Because of the lack in speculative appeal its development was delayed for 10 to 15 years. In 1935 when the fixed investment trust failed to prove a success, financiers established the management type of open end companies. Under this plan purchaser's of open end company shares received a right to participate in an investment fund that was invested in a wide diversified number of securities. The open end companies' net asset value has grown from 450 million dollars in 1940 to over 1 billion 400 million dollars.

Characteristics of Open End Company Stock

Capital Structure

Because of the Investment Act of 1940 all new open end companies are forbidden to have a funded debt, although they are allowed to receive bank loans provided their assets are 300 percent larger than their bank loan. This single capital structure system of the open end companies gives it a far more conservative picture than the closed end companies.

Redemption Privilege

Open end companies are required by their charter or by-laws to redeem all their shares when offered for redemption. Thus open end companies are forced to invest their funds in

marketable securities.

It is in a situation similar to a bank, it must have cash reserves on hand to cover any situation that might develop. It is reported that in 1938 because of the large number redemptions in open end company shares, it was necessary to market almost three dollars' worth of shares for every dollar invested by the open end companies. On the whole, most open end companies agree to redeem their shares at a net asset value at the time of redemption. However, several other plans of redemption exist and they are:(1) (1) the liquidating value of the fund as of the second business day after the shares are tendered for payment, (2) to redeem the shares at the next published bid prices which are based upon the net asset value of the next business day. As the issues are redeemed by the companies there is no need for listing open end shares on the Stock Exchanges.

Investment Policies of Open End Companies

The investment policies of open end companies vary from the ultra conservative type fund that is invested in high grade bonds to the highly speculative type fund that invests in common stock and special situations. The table on the opposite page presents the portfolio composition of 39 companies whose investment policies are representative of all groups from the conservative to the speculative. This table reveals that the average open end company practising the

(1) "Management Investment Trusts" J. V. Sands, Page 29

Table 6 The Distribution of Assets of 39 Open End Companies as of December 31, 1947

Company	Net Cash & Gov't Sec.	Bonds	Pfd Shares	Common Shares
Balanced Fund Companies				
American Business Fund	11%	24%	8%	57%
Axe Houghton Fund	7	1	15	77
Commonwealth Invest. Co.	13	8	20	59
Eaton Howard Bal. Fund	12	9	23	56
Fidelity Fund Inc.	15	8	11	66
First Mutual Trust	9	26	1	64
Investors Mutual Inc.	5	12	31	52
Manhattan Bond Fund	3	97	-	-
The George Putnam Fund	20	16	12	52
Seudder Stevens & Clark	15	16	10	59
Bond Inv. Trust of America	7	93	0	-
Wellington Fund	28	10	10	41
Average Balanced Fund	18%	12%	7%	60%
Divirsified Common Stock				
Affiliated Fund	3	-	1	96
Boston Fund Inc.	17	14	19	60
Bullock Fund	13	1	3	83
Dividend Shares Inc.	11	-	2	87
Equity Fund Inc.	2	-	5	93
Financial Industrial	8	-	-	92
General Capital Corp.	9	-	8	83
Incorporated Investors	5	2	2	91
The Investor Co. of America	11	-	-	89
Investor Management	5	1	3	91
Investor Stock Fund Inc.	4	1	-	95
Loomis Sayles Mutual	11	5	7	74
Mass. Investors 2nd Fund	4	-	-	96
Selected American Sec.	13	-	3	84
State Street Investment	17	2	5	76
Average Common Stock	8	2	7	82

Source: Arthur Wiesenberger "Investment Company 1948
Page 101

Table 6 (Con't) The Distribution of Assets of 39 Open End Companies as of December 31, 1947

Company	Net Cash & Gov't Sec.	Bonds	Pfd Shares	Common Shares
Broad Street Investing Co.	7%	3%	-	90%
Chemical Fund Inc.	10%	-	-	90%
Fundamental Investor Inc.	6	1	2	91
Knickerbocker Fund	5	-	-	95
Nation Wide Securities	11	24	22	43
National Investors Corp.	3	-	-	97
Trustee Industry Share	8	-	-	92
Total Average of Growth Companies	7%	4% -	6%	84%
Total Average of all Open End Companies	11%	6%	7%	76%

Source: Arthur Wiesenberger "Investment Company 1948"
Page 101

balanced fund policy had 14 percent of the total assets invested in cash and government securities, 28 percent in bonds and 13 percent in preferred stock and 45 percent in common stock. The average divisified common stock fund company was said to be 8 percent invested in cash and government securities, 2 percent in bonds, 7 percent in preferred stocks and 82 percent in common shares. The speculative or growth policy and companies that had no special policy were said to have had 7 percent in cash, 4 percent in bonds and 6 percent in preferred and 84 percent in common stock. The overall average of the 39 open end companies was 11 percent, 6 percent, 7 percent and 76 percent respectively. However, with the picture of business today it appears that much to little cash has been kept on hand for any emergency that might arise.

Loading Charges

All investors who purchase open end shares pay a commission in the form of loading charges or selling charges. This charge is said to cover the cost of distribution, and every investor should expect it to occur, however he has the right to know how much of his money will be invested in funds and how much to pay the cost of distribution.

The S. E. C. in its reports on "Investment Trust and Investment Companies" revealed that the loading charges were too high. Charges from 7 percent to 8 percent of the selling price were being paid by the investor. However, when one considers that no charge is made for redemption the loading

charge is some times not too high. Many industrial securities have a larger loading charge per share when the costs of commissions and transfer taxes are computed.

Future of Open end Shares

Open end shares have a good future ahead of them. The funds have been growing steadily since 1940. The net assets of open funds has increased more than 300 percent from $400,000,000. to $1,500,000,000. In 1947 when a 30 percent decline was registered in the stock exchange transactions, open end shares declined only 21 percent while it increased in the number os shareholders by 16 percent.(1) The wise use of an advertising program that will educate the public about the open end funds and create confidence in the companies may soon find the insurance companies with a strong competitor for the small investor's savings. Already the sales of new open end shares showed a total of $587,000,000. for the period 1945-1947. While the total corporate stock issues sold during that period was only $3,300,000,000. Besides receiving 18 percent of all new money obtained through new stock issues the open end companies were said to have received 6 percent of all corporate issues sold for the period 1945-1947.(2) This is an indication that the small investors desires protection through a wide divirsification of investments as the insurance companies provide and yet receive a higher return.

(1) Arthur Wiesenberger, "Investment Companies 1948" Page 197
(2) Ibid Page 198

CHAPTER X
DIVIDENDS

Dividends paid by investment trust companies are said to be derived from the following sources:

1. From investment income
2. From capital gain.

Investment income may be defined as income that is derived from the dividends and interest received from the securities held in the portfolio of investment companies. It is regular and recurring income that though it may fluctuate is sure of being received each year. Income from capital gain is income derived from the gain on the sale of securities. This type of income can not be believed to be recurring or steady. It only results when market prices of the portfolio rise and management's decision to sell at that time. Thus this type of earnings differs from investment income because it is: (1) non recurring and should not be computed in the return of the investment, (2) subject to a lower tax under the capital gain laws, (3) not ordinary income but rather profit from appreciation on security.

Because the earnings are derived from two different sources mentioned above it is important here to note that we have investment trust managers who cling to one or the other school of thought. One investment management may believe the purpose of his investment trust it to derive its income from investment income and any income derived from capital gain be placed in reserves to cover against future losses in its portfolio. The other investment trust management may believe

that its real source of income is from gain in the appreciation of its securities. Thus in years where this company receives no gain in the sale if its securities it has technically suffered a loss.

During the decade of the twenties many American trusts operated on the principle that all capital gains were income and should be distributed to the stockholders. As a result, we all know that because these investment trusts failed to set up reserves with income from capital gained, they suffered huge losses in their portfolio in 1929.

From a study made from 35 closed end investment(1) companies it was found that 14 companies, 40 percent had failed to pay dividends on their common stock for periods ranging from 3 to 10 years. A further breakdown of the 14 companies reveals the following information

1. That 3 companies or 21.6 percent failed to pay for a ten year period
2. That 1 company or 6.1 percent failed to pay for a nine year period
3. That 3 companies or 21.6 percent failed to pay for an eight year period
4. That 4 companies or 29.0 percent failed to pay for a seven year period
5. That 1 company or 6.7 percent failed to pay a dividend for a three year period
6. That 2 companies or 13.3 percent failed

(1) Arthur Wiesenberger, "Investment Companies 1948" Page 119-192

to pay a dividend for a two year period. of the 60 percent that remained, dividends were paid over a 10 year period although many of them paid small ones, ranging from 10 cents to 50 cents a share.

Of the 14 companies that did not pay a dividend from 3 to 10 years it was also found that 8 of them had debenture bonds and notes payable outstanding that could account one reason why they had such a poor dividend paying record.

Dividend Record of Open end Companies

The dividend records of 39 open end companies show very good results from the period 1936-1947.(1) Of these 39 companies only 3 are reported to have failed to pay a dividend and all 3 failed to pay only for a one year period. Perhaps the reason why many of these investment companies were able to continue to pay dividends over the eleven year period is because they have been rather conservative in their investments. The majority of these companies seem to have derived over half of their dividends from investment income sources rather than by capital gain.

Dividend Policies of Investment Company

There are said to be three investment policies that can be followed by investment companies. The first type is a liberal policy which calls for the granting of a dividend equal to earnings received from investment income and capital gains.

(1) Arthur Wiesenburger "Investment Company 1948" Page 200-258

The second type policy calls for a conservative outlook. All earnings received from capital gain be set aside in reserves against decline in the portfolio. Under this plan one third to one half of the net earnings in investment income be paid out in dividends.[1] The third is a middle of the road policy that calls for a partial accumulation of capital gains in reserves against decline of the portfolio and the payment of the rest of the capital gain earnings out along with 2/3 of the earnings of investment income.

Unfortunately, many investment trusts are forced to use the first policy of granting dividends received from investment income and capital gain without setting aside a reserve against possible decline of the portfolio. The reason for this is the tax status of investment trusts is different from that of normal corporations. As a result of this tax ruling the majority of investment trusts have been forced to adhere to the first dividend policy.

Tax Status of Dividends

Because corporate dividends are subject to double taxation in the form of corporate income tax on earnings and income tax on the stockholder's earnings. Congress realized that the holders of investment trust securities would be penalized if the investment trusts were subject to a corporate income tax. As a result Supplement Q was passed which contained the following provisions:

(1) Durst, "Analysis and Investment Trust Handbook", Rand McNally and Co. Page 93

1. That all regulated investment companies that distribute their investment income and capital gain each year are entitled to pay no tax on the income. The Shareholders of the trust are taxed as if the income they received had been earned by their own direct investment. The dividend representing capital gain may be treated as a capital gain by the individual taxpayer; in which case he may pay a 25 percent tax if he so desires to report the long term capital gain as such.
2. Only a regulated investment company may elect to operate under regulation Supplement Q provided it meets the following qualifications:
    a. all earnings are paid out asdividends each year
    b. they continue to pay dividends each year and agree that their policy is irrevocable.

Any company failing to take the advantages of Supplement Q must pay a corporate income tax on all earnings like any other private corporation. These rates run 20 percent for capital gain and 38 percent tax on other income.

Thus Supplement Q has been hailed as a great boon to investment companies and at the same time criticized. While the elimination of the double taxation burden is agreed by all a great help to the investment trust, the provision that

any undistributed capital gains are subject to a 25 percent tax forces the management to pay out all current capital gains as dividends rather than build up a reserve against future decline in the portfolio values. Thus as a result of this ruling management of regulated companies must decide which alternative to take.

Since there are no mandatory requirements as to the distribution of capital gains by the investment company many companies try to encourage their stockholders to take the dividend in the form of stock dividend. Some of the plans even grant the additional stock free of th $7\frac{1}{2}$ percent load or selling charge. Other companies pay an optional stock or cash dividend. The two opposing management viewpoints on the situation are thus clearly seen. The management that has a relatively secure position willingly grants a dividend on its entire capital gain so as to save the individual stockholders from extra tax burden. The other type of management because the company's position is not too secure and the prospects for the future are not very good. Thus they believe it's wise to pay the 25 percent tax on undistributed capital gains and build up a large reserve. Thus we see two opposing views of management which are acting in good faith for their stockholder's benefit.

CHAPTER XI
OUTLOOK OF INVESTMENT TRUST STOCK

The Position Today

The position of investment stock today has been very good. Discounts on the stocks have been slowly closing which indicates that the trend of increased buying of investment company stock has been growing. For a time in 1946 the discount rate was as low as 15 percent but the subsequent market weakness resulted in again with the shares selling at a sizeable weakness, Standard & Poor's report (1) that the discounts for 1948 have been smaller than that of 1947. Accordingly, this could be a reflection of the fact that companies have achieved creditable records through their far sighted policies that were developed over the past 10 years. Another point is that the investment companies' equities have a much more solid position as a result of the retirement of bank loans, funded debt and preferred stock over the ten year period.

Attitude of the Investors

It is hard to judge the attitude of the investors and their reactions to investment trust shares because their reactions are largely psychological in nature. Many times people have acted entirely the opposite from what would be considered reasonable, simply because of mass psychology. If everyone sells, they all will sell even though the security may be of the highest grade. Table7 shows that the sales of investment company shares has decreased in the third quarter

(1) Standard and Poor's Industry Survey Oct. 8, 1948 Page 12-2

MANAGEMENT INVESTMENT COMPANIES
SECURITY TRANSACTIONS AND NATURE OF ASSETS

ITEM	TOTAL - 187 Companies		102 Open-end Companies		85 Closed-end Companies	
	1948 Third Quarter	1948 Second Quarter	1948 Third Quarter	1948 Second Quarter	1948 Third Quarter	1948 Second Quarter
Registrants' Sales and Purchases of Own Securities						
Capital Stock						
Sales						
Number of shares	7,809,909	9,934,813	7,800,595	9,729,569	9,314	205,244
Net proceeds (dollars)	60,997,869	96,190,818	60,964,352	76,609,303	33,517	19,581,515
Purchases						
Number of shares	3,910,630	5,615,706	3,855,716	5,354,989	54,914	260,717
Net cost (dollars)	29,428,851	41,290,300	28,295,750	38,798,916	1,133,101	2,491,384
Balance1/						
Net sales -number of shares	3,899,279	4,319,107	3,944,879	4,374,580		
-net proceeds	31,569,018	54,900,518	32,668,602	37,810,387		17,090,131
Net purchases-number of shares					45,600	55,473
-net cost					1,099,584	
Funded Debt						
Sales						
Principal amount (dollars)	0	90,000	0	0	0	90,000
Net proceeds (dollars)	0	90,000	0	0	0	90,000
Purchases						
Principal amount (dollars)	59,038,780	2,109,800	0	0	59,038,780	2,109,800
Net cost (dollars)	65,492,575	2,090,199	0	0	65,492,5754/	2,090,199
Balance1/						
Net sales -principal amount			0	0		
-net proceeds			0	0		
Net purchases-principal amount	59,038,780	2,019,800	0	0	59,038,780	2,019,800
-net cost	65,492,575	2,000,199	0	0	65,492,575	2,000,199
Portfolio Changes during Period2/ (Thousands of dollars)						
Purchases	118,884	256,325	90,409	143,610	28,475	112,715
Sales	94,410	161,818	62,646	97,784	31,764	64,034
Balance1/	+ 24,474	+ 94,507	+ 27,763	+ 45,826	- 3,289	+ 48,681
Nature of Assets at Close of Quarter (Thousands of dollars)						
Cash and cash items3/	125,019	128,356	59,895	65,004	65,124	63,352
Government securities	129,862	205,910	55,635	59,897	74,227	146,013
Securities of other investment cos.	98,877	108,215	3,764	3,819	95,113	104,396
Other securities	2,841,319	3,041,763	1,420,110	1,463,979	1,421,209	1,577,784
Other assets	25,959	25,190	38	68	25,921	25,122
Total assets	3,221,036	3,509,434	1,539,442	1,592,767	1,681,594	1,916,667

1/ Represents the excess of sales over purchases or purchases over sales.
2/ Excluding purchases and sales of government bonds.
3/ Including receivables.
4/ Represents mainly cost of redemption ($64,762,010) of outstanding funded debt by one company now in liquidation.
Note:

The data in this table were obtained from quarterly reports filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and Section 30(b)(1) of the Investment Company Act of 1940. Such reports are filed by management investment companies registered under the latter Act, except companies which issue periodic payment plan certificates or which are sponsors or depositors of companies issuing such certificates. The reports are filed by fiscal quarters, and in most cases these correspond with calendar quarters; when the fiscal quarter is not a calendar quarter, the report is grouped with the calendar quarter to which it most closely corresponds. These data include all companies reporting for the second and third quarters of 1948. Figures in this table may differ from figures which appeared in earlier issues of the Statistical Bulletin because of receipt of amendments and additional reports, or because reports have not been received from some of the companies previously represented.

Source: "Statistical Bulletin" S.E.C. Jan.1949

about 3/8 or $37\frac{1}{2}$ percent while the purchases of the shares decreased around 50 percent. A further study shows that the retirement of the funded debt has been 29 times larger than that of the second quarter's purchases. This improved position of the stockholders will tend to attract investors who previously hesitated because they feared there was either too much leverage in some companies or not enough protection of the stockholder's equity.

Outlook of Investment Company Shares

An examination of the business conditions today must be combined in the analysis of investment company shares. One of the sources of earnings is the investment income from the securities held by the investment companies. Naturally an analysis of the future business conditions in 1949 must be made. Today there are two schools of thought as to what type of a period we are in. Some analysts insist we are in the beginning of a depression while others insist we are in the process of a leveling off period, which now seems to have reached its level. I believe that the second school of thought is the more correct one. The past three years of high prosperity was due to the pent up demand for household accessories, automobiles and building programs. Yet 1949 will be a prosperous year but a more competitive one in that American manufacturers will have to start selling their products to the consumer again! Some economists and observers believe that there is still a large market for the

various household appliances, automobiles and housing that will present itself when the prices of these items are lowered.

The earnings for 1949 will, I believe, be reduced in some fields. Because of this some dividends will be smaller but not drastic enough to cause a large drop in the investment income of investment companies. Thus the outlook for ordinary dividends of net investment income on the average is expected to hold up reasonably well and may even continue at a somewhat higher rate in certain industries.

Outlook of Security Profits

The outlook for security profits for 1949 is uncertain. There are favorable and unfavorable factors that may effect stock markets either upward or downward. The favorable factor is the reduction of margin requirements to 50 percent. This may attract more investors in the market. Another favorable factor is the campaign of stock exchanges and brokers to attract the small investors seems to be meeting with some success. The unfavorable factors are:

1. The threat of the proposed 2 billion corporation tax by the government
2. The fear of war by the investing public
3. The market fluctuation between 175 and 170 with no significant sign to show if the market is failing or rising.

These three factors have had the effect of scaring investors away from the market. People will not invest when conditions

are so uncertain as they are today. Confidence in the stock market must be built up before the security profits outlook for the investment companies becomes any brighter.

Summary

Though business for 1949 may be a little slower and somewhat smaller than the activety in 1948, I believe that the investment company's shares will yield an average of 4 to 6 percent a share may be a reasonable investment. The wide diversification of securities held will tend to give the companies good protection against any large decline in their portfolio.

CHAPTER XII
THE ANALYSIS OF CLOSED END INVESTMENT COMPANY SECURITIES

Unfortunately there are no wholly satisfactory method of comparison for investment companies as there are in industrial and public utilities companies. The analysts of investment companies do not have certain reliable ratios that industrial companies have instead he can only make comparisons with investment companies of a similar nature. The question on the analyst's mind is, "What would some one else do with the same fund and same freedom of action and during the same period of time?"

An investor seeking to invest in closed end company stocks should decide which class of stocks he wishes to buy.

That class which has:

1. Maxiumum safety and steady income
2. Reasonable income
3. Speculative

In this chapter I will discuss the characteristics of these three classes of securities and show with various examples what I believe should be the salient points to look for in analyzing stocks of the various classes.

Maximum Safety

Closed end company stock having the maximum safety and steady income are known as non leverage companies. The capitalization of such companies consist entirely of common stock. Thus any large increase or decrease in asset value do to senior obligations is avoided.

As such companies have no leverage factor to increase or decrease the asset value the performance relative test that shows management's record of performance is one method whereby an analyst may determine the best non leverage company.

However in making a comparison one should compare the companies over a period of years rather than by individual years as in separate years several companies may have identical performances while very few have the same record over a period of years. Take for an example the following companies showing the percentage increase or decrease in net assets for 1942-1947.

	1946	1945	1944	1943	1942	1937 - 1947
Lehman Corporation	+2%	+39%	+16%	+26%	+13%	+81%
National Bond & Share	-4%	+35%	+14%	+22%	+8%	+50%
Insuranshare Certificates	-10%	30%	+6%	+11%	+5%	+63%

A comparison of the investment performance of these individual non leverage companies with the average for all non leverage companies for the 1937-1947 period which was 68%.(1) Thus by simple comparison one may pick a company that shows a record better than 68% if the following anaylses show up very good. A further analysis should take into account what the average discount for non leverage companies stock should be. The market prices, net asset ratio or discount of non leverage companies. The 1937-1947 discount has been around an average of 30%. Below are two non leverage companies whose discount or market price, net asset ratio have ranged from the following:

	Lehman Corp.	National Bond & Share
1936	87%	83%
1939	69%	98%
1940	70%	76%
1941	76%	66%
1942	85%	82%
1943	79%	81%
1944	86%	80%
1945	93%	80%
1946	86%	82%
1947	99%	85%

Source: Standard & Poor's Industry Survey

Investment Company Oct.8,1948 page 12-9

(1) Arthur Weisenberger "Investment Companies 1948 page 65

After a careful analysis is made of the discount that the closed end companies are selling for and the investment performance of the various companies are compared over a long period of time, one should compare the dividend and income records of such companies over a period of years. An example below shows the record of several non leverage companies with respect to dividends and income.

	Income			Dividends		
	1946	1945	1944			
Lehman Corp.	1.65	1.39	1.39	6.35	3.8	1.40
Insuranshares Cert.	.26	.29	.28	.225	.225	.225
National Bond & Share	1.07	.94	.90	3.37	2.00	1.00
	% Return of Income to Market Price			% Return Dividend to Market Price		
Lehman Corp.	4%	3%	5%	15%	10%	7%
Insuranshares Cert.	3%	3%	3%	3%	2%	3%
National Bond & Share	4%	4%	5%	15%	9%	5%

Source: Arthur Weisenberger "Investment Companies 1947" Page 92

This example above shows that the ratio of income to current stock market price average about 3 percent and the ratio of dividends to current stock market prices of the company's shares range from 2 to 15 percent.

Thus it is not uncommon to see the stock of non leverage companies to sell at a discount of 30%.

Another analysis or method of comparison is to compare portfolio composition of the individual companies with the average of all such companies. Unfortunately such an average portfolio composition is constantly changing according to the business conditions and the stock market position. Today at the present moment the average of non leverage companies is said to be 13.4% in cash and government securities, 6.2% in preferred stock and 80.4% in common stock. By exa-ing the portfolio composition of a non leverage company with this temporary standard may show if the company is acceptable or not.

The expense ratios of non leverage companies when compared with the investment performance are a good indication whether a firm is doing fairly well or poorly. According to the latest standards for non leverage companies the ratio of expenses to gross income and expenses to net assets to be 12% and 2/3 of 1% respectively. However any company having a higer expense ratio than another non leverage company may be a better investment if its investment performance record has been much higher than the non leverage company having the lowest expense ratio.

The gross income results of non leverage companies have been found to be an average of 4.2%of the net asset value in 1947 and to have been 3.5% in 1946 and 3.3% in 1945 while the Standard and Poor's 90 Stock Index which represents a fully invested position have been 5.5%, 4.4% and 4.2% respectively.

In making the final analysis the investor should set up a list of the non leverage companies and see which have paid consistent dividends. A study of several non leverage companies reveals that they all have been paying a dividend over the past 10 years.

In summation the analyst choses that company which has the best performance record,reasonably low expense ratio compared to the performance record and havin a reasonable return being paid out consistently over the period of years.

Reasonable Income Securities

Closed end companies that are said to have a reasonable income are the low and moderate leverage companies. Because the existence of senior securities these companies have the ability to increase and decrease their asset value more quickly than non leverage companies. This is due to the average factor explained in the previous chapter. Because of this leverage the income one receives while on the most part it is steady will rise in periods of inflation and drop faster in periods of recescession. However as the leverage factor is not too extreme the companies have shown a record of reasonable steady income. In analyzing such companies the analysts must look for the following information:

1. The leverage factor of the low and moderate average companies.

2. The degree of risk of the company meaning the rate of senior capital to net assets.

3. The management record of performance

4. The discount range of such companies

5. The average income return and regularity of

dividends.

6. The expense ratios of these companies compared to the average leverage company of the same type.

An example below shows several companies that are classified as low leverage and medium leverage.

	Leverage Factor 1946	1947	Discount 1946	1947
American Gen.	1.9	1.0	6.7	26.
Bl.Ridge Corp.	1.5	1.3	16.5	22.
Carriers Gen.	2.1	1.7	37.5	33.
Capitol Adm.	2.6	2.1	47.9	52.
Gen. Am. Investors	1.6	1.6	26.6	25.
Equity Corp.	1.9	1.74	13.7	32.

Source: Arthur Weisenberger 1946 page 93

Thus it may be said that the medium and low leverage companies should have a leverage factor ranging from 1 to 2.9 any factor higher than 3 is said to be in the speculative class.

In addition to the examination of the leverage factor one should examine the individual companies for the ratio of senior obligations per share to the working assets per share.

	Working Asset per Share	Senior Obligations per sh.	Asset Val. of Common Share	% of Senior obligation to Working Assets
American Gen.	$ 6.78	$ 3.03	$ 3.75	46%
Bl. Ridge Corp.	5.67	1.19	4.49	20%
Carriers & Gen.	14.74	3.34	11.40	22%
Capitol Adm.	38.06	23.15	14.81	64%
Gen. Am. Investors	22.68	3.78	18.90	17%
Equity Corp.	4.92	1.88	3/04	31%

From the above table one must draw the conclusion that the ratio of senior obligations to net assets should range from 10-25% any figure greater than 25% is dangerous.

An Analysis of 3 medium an low leverage companies investment performance record reveals the following percentage change in net asset value.

	1946	1945	1944	1943	1942	1937-1947
Capitol Adm.	-3	+36	+18	+28	+15	+49
Chicago Corp.	0	+30	+21	+37	+16	+79
Equity Corp.	-5	+37	+24	+48	+19	+47
Gen. Am. Investors	+1	+42	+23	+46	+23	+117

The total investment performance for average companies of all types medium low and extreme leverage was 64%. Thereforee by analyzing each company in the above example one may see that the individual companies below 64% may be accepted as the extreme leverage companies have raised the average up some.

The discount range of the low and medium leverage companies has been said to range from 35 to 50% below the asset value. Today the average range has now risen to about 29-40%.

An analysis of medium and low leverage companies should reveal how much of the net income covers the preferred stock dividend requirements. A 200% income average is considered very necessary for both low and medium leverage companies and any company not meeting the requirements fall into the speculative class.

The return of gross income to net asset value of medium and low leverage companies as expressed in the table below has ranged about 4% over the past 3 years period.

	1947	1946	1945
Capitol Adm.	4.8%	4.0%	3.6%
Carriers & Gen.	4.9%	4.6%	4.4%
Equity Corp.	2.1%	9.5%	1.8%
Gen. Am. Investors	4.4%	4.0%	2.9%

The record of preferred shares of medium and low leverage companies has been very good. The average yield for dividends in comparison to market ratio has ranged from 4.1% to 6.3%. I believe that a preferred stock should yield between 6% and 5% and any yield above 6% is a little dangerous for a medium or low leverage preferred company stock.

The safety factor for preferred shares meaning the ratio of asset value to the market price should not be any less than 3, above 3 is said to be excellent.

Speculative Stock of closed end companies involves those securities that have a very high leverage factor. These securities depend for their value on participation and potential appreciation of the fund's portfolio. Therefore in such securities the analysis of dividend and income is secondary in importance.

The following ratios should be looked for in an analysis of several speculative closed end company stock:

1. The leverage factor for high leverage shares range from 3 to 10 times net assets per one dollar of the market price. Anything higher than 10 should be considered extremely high leverage shares.

2. Speculative securities usually have a high ratio of senior obligations to the net asset value ranging from 40 to 60%.

3. The performance of management expressed as a percentage change in the net asset value for speculative securities are of little use in the analysis as very often the poor records of previous years can be nullified in a rising market and give the appearance of a good record if individual

years are not examined.

4. High and Extremely high average securities have exceptionally poor dividend records.

5. The average safety factor of high and extremely high leverage companies preferred stock should be no less than 1. By safety factor we mean the ratio of asset value to market price allowing for senior securities.

Surmary

In conclusion closed end company securities with reasonable income may be said to be companies with a single capital structure. These non leverage compaies avoid the huge gain or skrinkage in asset value. The average more leverage company is said to have its stock sell at an average 30% discount. One can not set up what the ideal investment performance expressed as a percentage increase in net assets should be. However the average non leverage company's percentage increase in net assets ranged from 50 to 80 percent for the period 1937-1947.(1)

The ideal portfolio composition on non leverage companies has been said to be 13.4 percent for cash and government securities 6.2 percent for preferred and 80.4 percent in common stock.

The ideal expense ratios of expense to gross income and expense to net assets has been said to be 12 percent and 2/3 of 1 percent respectively.

(1) Arthur Weisenberger "Investment Companies 1946" Page 94

The ideal gross income returns of non leverage companies has been 3 percent of net assets.

Reasonable Income Securities

The ideal reasonable income security is said to be low and moderate leverage companies which are said to have an average leverage factor ranging from $1 to $3 of the net asset value for every $1 of the market price.

The ideal discount for such securities ranges from 25 to 40 percent.

The ideal ratio of senior obligations to the working assets should range from 10 to 25 percent.

The preferred stock dividend requirement such low and medium leverage companies have a 200 percent income coverage.

The ideal safety factor for preferred stocks should range between 3 and 4.

Speculative Stock

The ideal speculative stock has the following points to look for:

1. The speculative stock of closed end companies is composed of high and extremely high leverage shares. The ideal leverage factor to look for in such companies is 3 to 10 times the net asset value compared to every 1 dollar of the market price of the securities
2. The ideal speculative security should sell at a

discount ranging between 40 and 60 percent of the net asset value.

3. The average safety factor of the preferred stocks should be at least one.

CHAPTER XIII
ANALYSIS OF OPEN END COMPANY STOCKS

The analysis of open ends stocks may be broken down into the analysis of 3 groups of investment companies.

1. The conservative and steady income type
2. The moderately speculative reasonable income type
3. The speculative type

<u>The Conservative Steady Income Type</u>

The conservative steady income type is regarded as that type of stock that has the maximum safety feature in the protection of capital with the assurance of a steady yet low income return.

There are two types of open end company funds that are regarded as being safe and providing a steady income. They are as follows:

1. Bond fund type
2. Balanced Fund Type

The analysis of these funds involve the following procedure:

1. What is the company's portfolio policy?
2. What has been the investment performance of the individual bond companies over a period years
3. What have been the expense ratios of open end companies of the type mentioned above.

4. What has been the dividend and income return of such companies over the period of years

In the next few pages I shall give examples of the points I just mentioned try to setup some standards which I believe all conserative bond type, or balance fund companies need if they are to be considered safe.

Bond Funds

The policy of many bond funds is to invest the fund in divirsified high and medium grade bonds. The individual ivestor by consulting any of the statistical services such as Moody's, Fitch, Standard and Poors or the company's prospectus can determine the individual companies policy.

Below is an example of several bond type companies giving their portfolio composition as of December 31, 1946.

	Classication of Assets % in Cash & Gov't Sec.	Percentage in Bonds
Bond Invest. Trust of Am.	6%	94%
Group Securities Gen. Bond Share	4%	96%
Keystone Custodian Funds High Grade	50%	50%
Manhatten Bond Fund	3%	97%

The average dividend yield of those four investment companies to their net asset value at the end of the year was as follows:

	1946	1947
Bond Invest. Trust of Am.	4.1%	4.0%
Group Securities Gen. Bond Share	4.5%	4.2%
Keystone Custodian Funds High Grade	3.0%	3.1%
Manhatten Bond Fund	4.3%	4.1%

Thus the average return to be expected on bond fund of either high or medium grade should be abount 4%. Keystone Custodian Fund had the lowest because its fund was 50% in cash and government securities while the others averaged 6%.

After comparing the investment portfolio and dividend yeild to the net asset value the analyst should compare the investment performance of the bond type funds. An example below illustrates this:

	Percentage Increase or Decrease in Net Assets For				
	1946	1945	1944	1943	1937-1946
Bond Invest. of Am.	-2	8	8	10	57
Group Securities Gen. Bond Sh.	-9	17	40	33	- (1)
Keystone Custodian Fund High Gr.	2	6	7	17	38
Manhatten Bond Fund	7	12	29	28	- (2)

(1) Did not come into existence 1938
(2) Did not come into existence 1939
Source: Arthur Weisenberger "Investment Companies 1946" page 207

I believe that the average increase in net asset value for 1937-1946 for all bond type companies having a high grade medium policy should be 35%.

The ratio of expenses to net asset value for bond type funds should be 0.70%. Any company with a ratio larger than that may be overstepping it class but such a company should be compared with its performance record to see if the expense was warranted.

The selling charge or loading charge for such companies should average 9%. Any price higher than 9% for such investment trust securities is too high.

Balanced Funds

The balanced fund type of open end companies follow a middle of the road policy investing a portion of the fund in bonds and stocks.

What the portfolio composition should contain is very important below is an example of several balanced fund type companies that are very conservative and have a record of steady income.

	Portfolio Composition Dec.31,1947 Net Cash & Gov't Sec.	Bonds	Preferred	Common
American Business Fund	11	24	8	57
Axe Houghton Fund	7	1	15	77
Commonwealth Bal. Fund	13	8	20	59
Scudder Stevens & Clark	9	26	1	64

The average balanced fund should have the portfolio composed of 18% in government securities 12% in bonds, 7% in preferred shares and 60% in common shares.

The average expense of balanced fund companies should not be greater than 0.80% of the net asset value of the company.

The investment performance of the balanced fund companies for several companies below reveals the average increase in net asset performance for the period 1937-1946 should be 60%.

	Percentage Increase or Decrease In Net Asset 1946	1945	1944	1943	1937-1946
American Bus. Fund	-9	+38	+24	+37	+31
Axe Houghton Fund	-11	+33	+23	+34	
Commonwealth Bal. Fund	-2	+33	+20	+36	+75
Eaton Howard Bal. Fund	0	+21	+30	+10	+76
Fidelity Fund					
Investors Mutual Inc.	+1	+24	+20	+27	
The Geo. Putman Fund	-2	+19	+19	+22	+77
Scudder Stevens & Clark	0	+23	+19	+25	+58

Source: Arthur Weisenberger "Investment Companies 1946" page 205

The yield of balanced fund shares should average around 5.2%.

Reasonable Income Type

The reasonable income securities of investment company generally give up the safety in principal for a larger return or reasonable return of income. The divirsified common stock fund type has been classified in this group. However some divirsified companies are known to be conserative and could very well fall in with the maximum safety class. In general when we talk about reasonable income securities we mean the companies whose policies are either greater income producing securities or capital appreciation with a reasonable steady income.

In analyzing individual common stock funds the analyst or individual investor should investigate as to what policy the individual company follows; is it a special situation capital growth type, an increased income type, or appreciation in capital combined with a steady income. Such information can be obtained from any of the statistical services.

In analyzing common stock securities one should look for:

1. The policy of the company
2. The investment performance over a period of years
3. The portfolio composition
4. The loading charge

5. The ratio of expenses to net asset value

6. The average yearly yield on the individual shares.

The analysis of the investment performance follows the same pattern as other previous analyses. The companies below illustrate their individual investment performance

	Increase or Decrease in Net Assets				
	1946	1945	1944	1943	1937-1946
Affiliated Fund	-15	+ 72	+33	+60	+ 5
Boston Fund	- 2	+ 37	+20	+27	+44
Broad St. Investing	- 1	+ 40	+22	+33	+77
Bullock Fund	- 8	+41	+21	+30	+38
Delaware Fund	- 8	+41	+14	+26	-
Eaton Howard Stock	+ 1	+27	+23	+29	+54
Equity Fund	+ 7	+37	+26	+29	+45

The Dow Jones Composite Stock average for the period 1937-1946 was plus 60% and Standard and Poor's 90 Stock Index for the same period was plus 46%. As these two indices represented a divirsified number of stocks and a fully invested position I believe that the stock funds should range between 40% and 60% depending on whether the policy of the firm is greater income security or greater capital appreciation.

The average portfolio compsition of divirsified common stock funds has been found to consist of 8% in cash and government securities 29% in bonds, 7% in preferred shares and 83% in common stock. This average does not mean that all companies should be close to or adhere to the average. It is just a benchmark with which an investor can measure the individual companies with. Any variance should require an investigation by the investor to see if it is justified.

From a study of 14 divirsified stock funds it was found the average loading chare was 7.4%. This again is only a benchmark for an analyst to use to compare with the individual companies. The range for loading charges should be 7.4 to 9% of the net asset value per share. Any company whose ratio is higher than 9% should be examined to see if ratio is justified.

The yield of dividends to net asset value of 14 common stock funds ranged from 4 to 8.6%. However the average yield was said to be 5.5%. Using this as a benchmard any yield lower than 4% or greater than 9% for a common stock fund either makes the fund to conservative or too speculative.

The ratio of expenses to net asset value for stock funds should between 0.75 and 0.85% of net asset value. Any ratio below 0.75% is very good any any ratio above .85% is to be frowned upon.

Speculative Securities

The speculative securities of open end companies usually take the form speculative common stock funds, or divirsified common stock funds or thesingle industry common stock funds. As this group incloses a great variety of classes of open end companies, I shall try to show the characteristics of the speculative stocks, and what to look for in determing which speculative security is the best investment of its class.

Speculative open end securities have a set policy of investing in small unknown corporations with the intention of gaining capital growth rather than steady income. When the securities in such an open end fund's portfolio are profitable

enough they are sold and a capital gain dividend may be granted. Individuals investing in such an open end fund are looking for the increase in net asset value of their shares and not in steady reasonable income.

In analyzing such a company an individual should investigate the following:

1. What is the company's policy
2. What is its portfolio composition
3. Investigate the net asset value by studying the investment performance over a period years.
4. What is the loading charge
5. The ratio of expenses to earning

An examination of any of the statistical services or the prospectus of the individual companies will reveal if the company's investment policy is speculative or not.

The portfolio composition of speculative securities seems to follow the following pattern about 5% is invested in cash and government securities and 95% in common stocks. This is quite different from the conservative company's portfolio position.

The investment performance of the speculative companies over the 10 year period 1938-1946 average was an increase of 50% in net asset value any increase above that figure is very good and any figure below 40% is poor.

A study of 8 speculative investment company securities reveals that the loading charges should be no higher than 9% of the net asset value per share.

Many of the speculative securities are combined with other type funds and as a result the operating ratio of these companies is hard to determine. The general rule is that 0.80% of the net asset value is the limit for an operating ratio of speculative securities.

Over 50% of the dividends granted by speculative open end company funds is earned from the security profits. Thus as a result individuals investing in speculative securities should not expect a steady income. The average yield of a reasonably good speculative stock should be no greater than 8% and no less than5%.

CHAPTER XIV
REVIEW AND CONCLUSIONS

An attempt has been made in the preceding chapters to give a clear analysis of the investment status of investment company shares. In order to do this I covered certain rules and principles that I believed were necessary; such as the investment formulas the accounting methods used, the discount and leverage factor, because all were essential in the final analysis of the investment status. The study of the history I believe will prove that the investment companies have learned their lessons and are much more conservative in their business policies today. The investment companies, while I believe that there are good have certain factors that should be emphasized and they are:

1. The investment objectives
2. Management
3. Analysis of earning and dividends
4. Accounting methods
5. Government regulations

The various objectives of the investment companies are:

1 Capital appreciation through market speculation
2. Capital appreciation through the selection of a growth industry
3. Regular policy of safety of principal and stability of income through the investment of first class bond funds

4. The discovery of special situations where substantial committements and the possible participation in management over a long period of time will result in unusual appreciation
5. A middle of the road policy that provides for a steady income and permits some speculation in securities;

These five objectives are important to an investor who must decide which fund he wants to invest in. Thus by careful analysis of the individual investment companies according to these 5 objectives an investor can decide which type of trust he wants to invest in.

Management is an important factor to the analysis of the investment company as this is any company's greatest asset. Investors must not only examine their performance through the change in net asset performance but they must look for such human factors as the affiliation of management with other companies, their character and interest in the success of the company. All of these are important in the analysis of management in order to decide which investment company to invest in.

Analysis of earnings and dividends is very important to a prospective investor An investor should carefully determine what percentage of earnings is composed of investment income and what percentage is of capital gain as it will reveal to an investor what policy the company is pursuing

and give it an effective barometer to compare with other investment companies. The same reasons can be given for an analysis of dividends. One can not emphasize these two analyses too strongly as they are important to the investor's eventual success or loss in the investment company's shares.

The variety of accounting methods used by investment companies has caused many investment analysts to claim that the long run pictures of many investment companies are distorted. Thus the investor should make a careful study in the methods used by particular companies before purchasing their stock. Investors should not expect that the government's regulation of securities insures them against possible losses. The regulations by government only protects the investor against certain flagrant abuses mentioned in the chapter on regulations. All that the Investment Act of 1940 and state regulations try to do is to present full disclosure of the facts to the prospective investor.

<u>The Conclusion of the Report</u>

The investment trusts have a distinct and valuable service to offer to the small investors. The fundamental investment principle of divirsification is an important service. Their growth from 1.1 billion in 1934 to 3.2 billion in 1948, a growth of 191 percent shows that it has a definite place in the American financial life. The insurance companies which have long been accepted as first class investments are nothing more than investment trusts. I believe that by educating the

American public that the investment trusts can offer the same services and the insurance company with the possibility of a greater return, the investment trusts may expand to greater heights.

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